Fire Underwriters' Associations in the United States

By ROBERT RIEGEL

THESIS

PRESENTED TO THE FACULTY OF THE GRADUATE SCHOOL OF THE UNIVERSITY OF PENNSYLVANIA IN PARTIAL FULFILMENT OF THE REQUIREMENTS FOR THE DEGREE OF DOCTOR OF PHILOSOPHY

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A SURVEY AND CLASSIFICATION OF FIRE UNDERWRITERS' ASSOCIATIONS IN THE UNITED STATES

By Robert Riegel

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ALL text writers have emphasized the importance of fire insurance as a business necessity and if a more decided proof be desired one need only consider the many State investigations of this economic factor. Of the entire insurance field the most important division is that of rate-making or premium fixing, and yet one of the principal agencies exercising this function has received comparatively little attention by writers. The term "premium" in fire insurance refers to the amount paid by one having an interest in property to an insurer, in return for a promise of reimbursement for damage to the property by fire. Dwellings and mercantile buildings, with their contents, form the bulk of the property insured, and the premium, or the amount paid for insurance, is a matter of importance to the community as regards both home and business relations. It is included in the expenditures of families, firms and corporations. From fire premiums, in the last analysis, losses are paid. Many policyholders yearly contribute small amounts which are paid out to the unfortunate to settle losses, and if losses increase, premiums must increase, or the claims ultimately fail to be paid. Fire insurance premiums, since fire insurance is a necessity of business, and almost a necessity of life, are of vital importance to all, and this is also true of the property loss by fire, because of its effect upon premiums. That losses be as small as possible, and that insurance premiums be adequate, fair and consistent, are both to the interest of the American public. In spite of the fact that premiums and losses are of such vital importance the institutions most closely connected with them—underwriters' associations—have received practically no notice except individually by committees of investigation.

The amount of premium paid depends upon the amount of insurance carried and the rate. The rate is the premium per $100 of insurance, and criticism of the rates of fire insurance companies is not new. It has probably existed since the inception of the business, although in its early stages most people considered that rates were kept at a minimum because of the existence of competition. Criticism has doubtless had its good effect in the improvement of the methods of rating, from the time when insurance was on "common," "hazardous" or "doubly hazardous" properties to the era of the modern schedule,—when it has been based upon sound premises. At other times, however, it has resulted in the passage of laws which have injured the insurance business, the policyholders and the public. Valued policy laws were passed, requiring insurance companies to pay, upon the destruction of a building, the amount named in the policy regardless of depreciation since the underwriting of the risk.

Under such statutes it was to the insured's *advantage* to have his building destroyed and he made a profit thereby. Anti-compact laws came into existence, forbidding combinations in the fixing or maintaining of rates. By the passage of such laws States refused to permit combination, which was eliminating the discrimination in rates which had resulted from competition.*

Rate criticism has lately assumed a new phase, however, induced by the character of the means used to obtain rates, namely, underwriters' associations. No longer do we have all the companies, influenced by competition, reducing their rates to the lowest point consistent with their loss statistics, or even lower, or arriving by separate processes at the final rates which they grant on properties. They instead co-operate to centralize the control of rates—place the power with associations in which they, among others, are represented; and to the new methods the critics find new objections. It begins to appear as if rates might be placed at any point the companies choose and thereby become exorbitant. Competition eliminated, what check on confiscation exists? Were the rates, promulgated by the associations with the help of local schedules, *optional*, there would be no room for adverse criticism, but they are of little value if not *enforceable*. The money spent in obtaining a rating on a building would be wasted, if through competition a company were forced to discard the rate for a lower one. The present question, therefore, is not only whether rates shall be higher or lower, as may superficially appear, but is also one of method. Shall they be determined by competition or co-operation?

The Instruments of Rate-Making.

Many important insurance rates in the United States to-day are arrived at by the use of "schedules" such as the Dean or Analytic Schedule and the Universal Mercantile Schedule. Such schedules set forth the various disadvantages and good features in building construction, location and occupancy, with their respective additions to or deductions from a "basis rate." This basis rate is the rate for a standard building in a standard city, according to the Universal Schedule, and under the Dean Schedule for an "ordinary" building, which, however, is better than the majority of those in existence. Few or many items may be considered in such schedules, and they vary from the short schedule used in New England, containing 17 items, to the Universal Schedule with 3,400 items, including occupancy charges. By the use of schedules the following advantages are derived:†

1. Consistent and equitable rating.
2. Accurate rating, by taking into account each feature of construction.

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*In 1912 anti-compact laws existed in the following States: Alabama, Arizona, Arkansas, California, Georgia, Iowa, Kansas, Louisiana, Michigan, Mississippi, Missouri, Nevada, New Hampshire, New Mexico, Ohio, Oklahoma, Oregon, South Dakota, Tennessee, Texas, Washington, Wisconsin. (The Fire Insurance Pocket Index, 1913. Spectator Company, New York, p. 75). For the development of such legislation see the author's "Commonwealth versus Co-operation," THE MARKET WORLD AND CHRONICLE, June 12, 1915, or the same, "Rough Notes," April 22, 1915.

†Standard Universal Schedule for Rating Mercantile Risks, page 8.

3. As a consequence of the above, the prevention of opposition on the part of policyholders and legislators.
4. Encouragement of proper construction.
5. Tendency to prevent anti-compact laws.
6. Discouragement of excessive brokerages and commissions.
7. More thorough inspection.
8. Prevention of excessive deductions for fire departments.
9. Prevention of competition and rate-cutting.

The schedule having been prepared with as great scientific accuracy as is possible under present conditions, it is unnecessary for a company to prepare its own rating system, except for certain risks out of the ordinary on which it may grant insurance. The companies first co-operate, again as far as is possible under present conditions, in furnishing data for the compilation of such a schedule, and once worked out, collectively adopt it as a basis for their business. Many schedules are used, but they usually follow the principles of the Dean or the Universal Schedule, with adaptations for local conditions.

The Application of the "Schedule."

Having then a schedule, some human agency must be employed to apply it to the various risks. Obviously each company might individually employ raters to apply the schedule, but if there were two hundred companies doing business it would be folly to employ two hundred agencies to apply the schedule in a given locality when one might do it for all. The companies therefore quite naturally co-operate. If each company was compelled to inspect each building for itself, the expense of transacting business would be increased, with the result that premiums would be higher, to the detriment of those who must purchase insurance. The agencies which the companies establish in most communities to apply the schedules for them and so make the rates, are associations variously known as "underwriters' associations," "fire insurance exchanges," "unions," and "tariff associations."

State laws, however, sometimes intervene to prevent the companies from using the underwriters' associations to make the rates. In January, 1912, for example, a bill was introduced in the Legislature of South Carolina to expel from the State companies which were members of the Southeastern Underwriters' Association. In some instances the laws impose such penalties as prohibit companies from membership in such organizations. In 1897 the State of Alabama passed a law stating that if property insured under a policy issued by a company which was a member of any tariff or rating association was destroyed, the owner thereof might recover the actual amount of loss or damage, and in addition, twenty-five per cent of such loss or damage. The latter amount was a penalty imposed for the company's membership and participation in such an association.

After the passage of such laws the companies resorted to another device to enjoy the co-operation thus denied but which is necessary in the making of rates. Some party in a given territory made the rates and sold them to the companies there operating. These parties were known—for obvious reasons—as "independent raters," although the term is a misnomer. It is quite plain that the

independent rater is a device employed by the companies to do that which may not legally be accomplished through underwriters' associations. It is useless to co-operate in making or purchasing rates unless such rates are adhered to. These purchased rates were given to a stamping office, usually a department of an association, and the stamping office had the sole power to permit a change of rates. This was accomplished by the passage of a "relief rule." By such supervision the rates published are maintained. The New York Fire Insurance Exchange made rates for a certain portion of the State of New Jersey up to December 16, 1909, at which time it was forced to relinquish this function by a decision of the New Jersey Court of Errors and Appeals, declaring combinations to fix rates ultra vires, since this was an important duty of the officers of insurance companies, and could not, under the charters of the latter, be delegated to an association. The New York Exchange then sold its maps and surveys to an employe, who resigned his position with the Exchange and organized the "Hudson Inspection Bureau," which promulgated advisory rates in what was formerly the territory of the Exchange. Differences between Exchange members affecting this territory were still settled by the procedure of the Exchange.

The foregoing briefly shows the connection of these associations with the vital insurance function of rate-making.

Types of Associations.‡

Underwriters' associations may be divided into types or classified, (1) on the basis of the extent of territory in which they operate; (2) according to their functions or objects; and (3) with reference to the character of membership.

CLASSIFICATION OF ASSOCIATIONS

According to—

1. Jurisdiction
   - National
   - Sectional
   - Local
     - Urban
     - Suburban
2. Functions
   - Technical and educational
   - Regulation of brokers and agents and rate-making
3. Membership
   - Occupation of members
     - Company representatives
     - Special agents
     - Agents and brokers
     - No distinction between members
   - Classification of members
     - Classified membership
       1. Without qualification of voting power
       2. With qualification of voting power.
   - Requirements
     - Adherence to agreed commissions to agents
     - Adherence to stated scale of brokers' compensation

‡See J. B. Kremer, "The Agency," an address at the Ninety-first Meeting of the Insurance Society of New York.

Types of Associations.

According to territory, the various organizations may be divided as follows:

1. Local.
   (a) Urban.
   (b) Suburban.
2. Sectional.
3. National.

While the last two terms are to an extent self-explanatory, "local" is somewhat misleading, giving the impression of a small unimportant body in a very restricted territory. It may, however, apply to organizations concerned with the largest cities, to those with jurisdictions extending beyond city limits, or to those within a city proper, with suburban territory excluded. The New York Fire Insurance Exchange has no jurisdiction over suburbs, these being the territory of the Suburban Fire Insurance Exchange, but its activities extend beyond the city of New York proper.

Local associations might be subdivided into urban and suburban, therefore, the city of New York furnishing an example of such division of territory. The Suburban Fire Insurance Exchange there extends over Westchester, Putnam, Rockland and Richmond counties, the Bronx east of the Bronx River, and all of Long Island outside of the Borough of Brooklyn; while the New York Fire Insurance Exchange supervises, roughly, Manhattan, the Bronx and Brooklyn. Similar instances might be cited elsewhere.

Other local associations operate within a single State, but with jurisdictions ranging from two or three counties to almost an entire State. The type in mind is best described by illustrations. The Allegheny County Underwriters' Association covers several counties in the western part of the State of Pennsylvania, and is one therefore with a comparatively limited area. The Underwriters' Association of New York State has a broader field, covering all of the counties north of Putnam and Westchester, with the large cities excepted. These two kinds of associations are both included under the term local to avoid a too elaborate classification, as they are somewhat similar in other respects. The local associations, although operating in a smaller field than the sectional and national, are extremely important by reason of the character of the work they perform—supervising brokers, agents and rates.

The sectional organizations' territories are wider in extent, and cover from two or three States to half of the United States. The Eastern Union covers that part of the country east of the Mississippi; the Western Union, broadly speaking, the Middle West; and the Middle Department operates in Pennsylvania, Delaware, Maryland and West Virginia. Such organizations perform, in a broader way, somewhat the same functions as the local associations, in territory not covered by the latter. The Eastern and Western Unions are what may be termed "company" organizations, their principal object being the equalization of commissions. The interests of the field force may be directly opposed, therefore, to the interests of these two unions, as, for example, when reduction of commissions is desired. These co-operative bodies have considerable influence with the local boards which make rates, since some of the latter owe their very

existence to the endeavor of the sectional unions. The local associations, however, must not be considered as branches of these larger bodies, for a company may be represented in a local underwriters' association or many of them, and at the same time not be a member of the Unions. The connection between the different classes is indirect, but nevertheless exists. The Middle Department, however, is a special agents' organization, and is similar in nature to the local bodies, having for its objects the making of rates, inspection of policies, establishment of a stamping department, and the regulation of commissions. Many of the local boards in the territory of the Middle Department have been organized through the activity and influence of this body. It makes agreements with local bodies, for example, with regard to rates and commissions.

There are, in the main, two fields of activity in which underwriters' associations engage, namely, efforts to improve the practices of the business, and, secondly, measures which may be termed educational. Insurance may be viewed from one standpoint as the furnishing of indemnity for a proper consideration; or in a broader light, as having also a duty to teach the methods of reducing fire waste, as a doctor points out means of avoiding illness. The educational activities of the associations are directed toward the fulfilment of the latter duty.

The local and sectional associations are in the main concerned with the practical aspects of the business, and the national bodies with the educational aspects. The practical bodies are chiefly concerned with the subjects of rates and commissions, while the educational bodies, the National Board of Fire Underwriters and the National Fire Protection Association, direct their efforts toward preventing and reducing fire waste. This division of function must not be too much emphasized, for the local and sectional bodies are also greatly interested in the educational or conservation work. The Middle Department, for example, makes inspections and furnishes the advice of engineers, and the constitutions and by-laws of many of the local associations include in the list of objects of association "the reduction of fire waste" and "the improvement of construction." Likewise the proper measurement of fire hazard, an object of local associations, is in itself one of the strongest influences in discouraging poor construction and in encouraging proper building and the use of fire-extinguishing facilities. The National Board, on the other hand, has recently undertaken the preparation of a new schedule rating system. (See p. 20.)

The national association (National Board of Fire Underwriters) and some sectional organizations (Eastern and Western Unions, Underwriters' Association of the Pacific, Rocky Mountain Fire Underwriters' Association and Southeastern Tariff or Southeastern Underwriters' Association) are company organizations, and comprise practically all the large stock companies in the United States. Other sectional organizations (the New England Fire Insurance Exchange and Underwriters' Association of New York State, for example) are composed of special agents. The local associations' membership is personal, consisting of managers, agents and brokers.

In some associations membership is divided into classes. Thus in the Board of Underwriters of Allegheny County three classes of members are included; agents who write more or less than $5,000 net premiums annually,

and brokers. In this association, also, the voting privilege of the latter two classes is qualified.

Some of the organizations require members to adhere to a stated commission rate. Notable examples are the Eastern and Western Unions. The following table gives an outline of the nature of some of the more important boards and bureaus:§

Date of Organization.	Name of Association.	Extent of Jurisdiction.	Functions.¶	Membership Composed of	Remarks.
1866	National Board of Fire Underwriters	National	Educational work Technical studies	Companies	
1879	Western Union	Sectional	Formation of local boards, regulation of agents and supervision of rates	Companies	Observance of agreed commission required
....	Eastern Union	Sectional	Regulation of agents, promotion of good practices	Companies	Ditto
1897	Underwriters' Association of the Pacific	Sectional	Regulation of brokers and agents, promulgation of rates	Companies	Ditto
1889	Rocky Mountain Fire Underwriters' Association	Sectional	Ditto	Companies	Ditto
1882	Southeastern Tariff Association	Sectional	Ditto-formation of local boards	Companies	Ditto
1883	New England Insurance Exchange	Sectional	Ditto	Special Agents	
1883	Underwriters' Association of New York State	Sectional	Ditto	Special Agents	
1883	Underwriters' Association of the Middle Department	Sectional	Ditto	Special Agents	
1899	New York Fire Insurance Exchange	Local	Regulation of brokers and agents, promulgation of rates	Agents and Brokers	
1883	Philadelphia Underwriters' Association	Local	Ditto	Agents ano Brokers	

¶Only the most important and distinctive functions are here given. A more complete description of purposes and services follows in later sections.

§It need hardly be stated that these were chosen for no purpose other than to illustrate the nature of the classes they represent.

Having briefly indicated the general nature of the various classes of associations, later sections discuss in detail the character and function of—

(1) The National organizations, of which the National Board of Fire Underwriters and the National Fire Protection Association are perhaps the most influential.

(2) The Sectional organizations, namely, the Eastern Union, Western Union and Western Insurance Bureau, and,

(3) The local bodies.

LOCAL FIRE UNDERWRITERS' ASSOCIATIONS*

Jurisdiction, Membership and Government.

OF all the underwriters' associations the local type, because of the number of such bodies and the character of their activities, is the most important. Some have jurisdictions which are limited to single cities, often excluding even suburban territory. Included in this group are also the suburban exchanges, which are not relatively so important as the urban, because of the smaller number of risks within their control. Taking two large Eastern cities as examples, there are the New York Fire Insurance Exchange and the Philadelphia Underwriters' Association. The former operates in substantially the present city of New York, exclusive of the suburbs; its territory includes, therefore, Manhattan, Bronx and Brooklyn boroughs, and in addition Long Island City and the American Dock piers in Richmond. The Philadelphia Underwriters' Association has jurisdiction over the City of Philadelphia, excluding suburbs. Both of these are unincorporated and voluntary in the sense that membership is not compulsory, but is very advisable from a business standpoint.

The local exchanges are in many cases the outgrowth of sectional organizations. Thus the New York Fire Insurance Exchange was organized in 1899 in pursuance of a by-law of the New York Board of Fire Underwriters, a State association, to the effect that its members might organize rating associations. Local exchanges' membership is usually personal and includes principally

*The facts upon which this section are based were derived chiefly from the following sources:

Report of Joint Committee to Investigate Insurance, State of New York, February 1, 1911.

W. O. Robb, "New York Fire Insurance Exchange," Popular Insurance Magazine, January, 1911.

Report on Examination of New York Fire Insurance Exchange, July 21, 1913. New York State Insurance Department.

New York Fire Insurance Exchange, Annual Reports of the Manager.

Handbook of the New York Fire Insurance Exchange, July, 1910, revised to January, 1914.

Philadelphia Underwriters' Association By-Laws, Agreements and Rules, June, 1908; revised to 1913.

Wiedenhold, Louis, Jr., "Underwriters' Associations," Bulletin of Fire Insurance Society of Philadelphia, Special Supplement, May, 1912.

brokers and agents. In 1911 the New York Exchange included about 55 companies represented by officers or managers and about the same number of head agents representing one or more companies in the territory named.† Practically all of the companies admitted to the State of New York and doing business in New York City are represented in the Association, either by officers, managers or head agents. The Philadelphia Underwriters' Association is substantially of the same nature.

Membership in local associations is obtained by application in writing, accepted by a committee appointed for this purpose and usually known as the Committee on Brokerage. The applicant must be a person representing, as officer, broker or agent, some insurance company doing business in the territory of the particular association. In addition he must comply with certain requirements promulgated by the committee and must agree to be bound by the constitution, by-laws, rates, commissions and forms.

Like most present-day associations, the government of the local exchanges is a government of committees. The most important is usually an Executive or Governing Committee, which is in general control of all activities and whose orders are executed by a Secretary or Manager. This Committee, which is usually elective, appoints various standing committees to take charge of particular branches of association work. The Executive Committee of the Philadelphia Exchange consists of nine members, four being representatives of Pennsylvania companies, three of companies from other States and two of foreign companies. Its duties are the following:§

(1) To maintain a department of surveys and inspection.
(2) To make rates, schedules, standards, etc., which shall be binding on all members.
(3) To prescribe rules and forms to be used.
(4) To make alterations in rates provided:
    (a) A change takes place in hazard or a change in the rates applicable to the risk.
    (b) A minimum, schedule or standard is adopted which did not before apply.
    (c) An error has been made in the application of a schedule, minimum, standard or rule.
    (d) A standard, schedule or minimum does not apply to the risk.
    (e) A cause is stated in writing and is one of these named above.
(5) To fix rates on risks of superior construction.
(6) To assess companies for funds to defray expenses. The assessment is made upon the basis of premium income.

A large portion of the actual work of an association is performed by standing committees appointed by the Executive Committee. The most important among these are:

(1) The Committee on Rates, which in the New York Fire Insurance Ex-

†W. O. Robb.
§By-laws, Agreements and Rules, June, 1908; revised to 1913.

change consists of seven members including representatives of local, agency and foreign companies. This Committee has charge of the rating work of the Exchange, to be later described. To some extent changes in rating originate with the working force, but the control and direction of the rating department rest ultimately with this Committee. It is virtually a court of appeals, hearing testimony on the application of schedules to particular risks, the introduction of new schedules and the revision of old ones.

(2) The Committee on Brokerage, which practically determines who shall be admitted to the association, investigating applications for membership and hearing any complaints against the applicant. If the candidate is considered a satisfactory person and has complied with the rules for admission promulgated by the Committee, the latter issues to him a certificate of membership. Among the rules prescribed for admission are usually the following:‡

(a) The applicant must have placed at least two risks with exchange companies, covering properties of two different parties, neither of whom is related to the applicant. The premiums thereon must have been paid in full.

(b) The applicant must be favorably endorsed by two independent references, one of whom is a voting member of the Exchange.

(c) He must be 21 years of age or over.

(d) He must agree that he will not give rebates or accept commissions in excess of those prescribed by the Association.

(e) He must agree to place all risks with Exchange members unless sufficient insurance cannot be so secured.

In addition to its administration of admission requirements the Brokerage Committee acts as a lower court to investigate complaints against members. The accused has an opportunity to appear and defend himself, but if convicted the Brokerage Committee imposes the appropriate penalty. An appeal may be taken from this decision, however.

(3) The Committee on Arbitration. A member receiving an adverse decision from the Brokerage Committee, as above described, may take an appeal to the Committee on Arbitration within ten days of the mailing of notice of such decision. This right of appeal is so restricted, however, as to make the Brokerage Committee in some cases a court of final judgment. Thus in one association the latter has the power to cancel certificates upon ten days' notice, and when it dismisses a member in this manner he has no redress. Upon other appeals the Committee on Arbitration investigates the complaint, having power to examine the books of any office, agency or branch office, and any person connected with such agency or office, under oath. Refusal to testify or submit books or papers is considered an admission of the truth of the accusation. Accountants may be employed to assist the Committee. Having arrived at a conclusion, the decision is announced and a penalty imposed, which may consist of a fine, enforced cancellation of any policies in question or of preventing the member from taking a particular risk or risks, either directly or by

‡Examination of New York Fire Insurance Exchange.

reinsurance, for one year. The last penalty is a serious one, as it may involve considerable loss of business, which possibly will never be recovered.

(4) The Committee on Losses and Adjustments. The purpose of this Committee is to promote good business practice and equity in the adjustment of fire losses. To this end it prescribes rules for the payment of claims. Thus some associations on the Pacific Coast have agreed that a rule known as the Kinne Rule shall be used for the apportionment of losses where non-concurrent insurance exists.

The Objects of Local Associations.

The statement of the objects of the New York Fire Insurance Exchange may be taken as illustrative of the general expression of local associations' purposes. They are as follows:

1. Mutual counsel.
2. Comparison of experience necessary for adequate and just rates.
3. Economical conduct of business.
4. Prompt and equitable adjustment of losses.
5. Ascertainment of proper and safe methods of building construction.
6. Prevention and extinction of fires.
7. Promotion of mutual interests of underwriter and property owner.

Of the purposes enumerated two are of most vital importance—the regulation of brokers and agents and the control of rates. The Joint Committee of the New York Legislature in its report states that "The object of the Exchange" (referring to the New York Fire Insurance Exchange) "is the control of rates and commissions to agents and brokers"; which perhaps gives an unfair impression, in view of the other activities of this body, but which certainly properly emphasizes two of the most important functions.

(1) Regulation of Brokers and Agents. One of the main objects of associations is to require the adherence by brokers and agents to a uniform scale of commissions. Thus, taking New York as an example, companies may compensate head agents or managers in any form or amount they choose. Branch office managers, however, receive commissions only for their services, these amounting to 25 per cent. These managers are authorized to write insurance only on risks of a less hazardous nature. A good portion of the 25 per cent is turned over to brokers, and the managers receive in addition what is termed an "over-riding" or excess commission of 12½ per cent. For this is substituted sometimes a contingent commission, depending upon the profit to the company on the business written by the branch.* Most associations provide that as regards risks located in the territory of other exchanges members shall abide by the rules of the latter.

Brokers receive commissions which vary with the class of business written, ranging from 5 to 25 per cent, as follows:

(1) On risks rated under the Restricted Sprinkler schedule, 5 per cent. This schedule is applicable to but few risks.

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*For various methods of compensation see G. T. Forbush, "Local Agency Compensation," a lecture before Insurance Library Association of Boston, 1912.

(2) On risks other than may be written by branch offices, (i. e., preferred risks of a less hazardous nature) 10 per cent (if in the congested district of Manhattan).

(3) On risks outside the congested district of Manhattan, said risks not being of the Branch Office class, 15 per cent.

(4) On risks of the Branch Office class, 25 per cent.

In order to do business with Exchange members, a broker must be placed upon the Certified List of Brokers maintained by the Exchange, which entitles a broker to whom a certificate is issued by the Brokerage Committee to receive a commission for business placed with its members. To obtain a certificate the broker must be engaged exclusively in the insurance business or allied occupations, such as real estate, and must make the following pledges:

Brokers' Pledge, Class I.—"In consideration of the commissions or brokerages at the current rate that may be fixed and established for the time being by, and to be paid by members of, the New York Fire Insurance Exchange, I hereby promise and agree that I will not, directly or indirectly, pay to or divide with any person not holding a broker's certificate, any commission or brokerage, nor will I receive from any company or agent, directly or indirectly, any remuneration for business placed with them, in excess of that permitted by the rules of the Exchange."

Brokers' Pledge, Class II.—"In consideration of the payment to be made to me of an additional five per cent to the commissions or brokerages as provided for in brokers' pledge, Class I, signed by me, I hereby promise and agree in addition to said pledge, that in placing insurance, I will give the preference to the members of the New York Fire Insurance Exchange, and that I will not place any risk with those not members unless I cannot secure sufficient insurance on such risks from members of the Exchange, in which case I agree to file with the Secretary of the Exchange, within one week of so placing, a list of such outside company or companies in which same has been placed, with the name of the assured, location of risk and the amount of insurance given them."

With reference to commissions it is also provided that no member may purchase the business of any broker on terms other than the rate of brokerage or commission fixed by the Exchange. .

Since practically all the large and reliable companies belong to the associations having jurisdiction in the territory in which they operate, membership in such associations is practically a business necessity. The rules usually provide that insurance shall not be placed with non-members unless the same cannot be secured within the ranks. In order to do business with Exchange members a broker must be on the certified list maintained by the Exchange, and the members do not recognize a person as a broker who is not named in said list. No Exchange member may represent a company outside the organization. It can be seen from this that the local associations have practically decided who shall engage in the fire insurance business in their territories exactly as the New York Stock Exchange decides who shall do business on its floor. The Brokerage Committees of some of the various associations have established rules as they saw fit and applied them as they desired. In New York State, however, the enactment of Section 143 of the Insurance Law requires the Super-

intendent to issue certificates to truthworthy applicants, and since he has been empowered by a recent law to examine the practices of all associations the latter have of late necessarily regulated the conduct of their brokerage departments so as to be in harmony with the policy of the State.§

The power of the Exchange is exercised over brokers and agents in various minor ways. Thus by one association premiums for insurance are required to be paid within forty days after the end of the month in which written, or notice of cancellation of the policy is to be sent to the broker and the insured. All members of the Association are also required to adhere to the rates of premium promulgated.

(2) Control of Rates and Forms. The extent of local associations' control over forms and rates will be best appreciated after a description of the procedure of rating. Three departments are concerned, namely, the inspection department, the rating department, and, often, the stamping department.

The association first comes in contact with the risk through an inspector. The insurance company, in accepting a risk, stands in the position of a buyer, and the thing bought is the privilege of insuring the owner of the building or contents, as the case may be. Being a buyer, it should have the opportunity of examining the thing purchased, i. e., should be allowed to see that the privilege is one which will result in a profit, not a loss. The inspector, therefore, really stands in the position of an expert buyer, representing one or more companies.

It is his business to note possibilities of fires beginning, entering or spreading on the premises, and all facts which can be secured relative to occupancy. The latter requirement necessitates a knowledge of the processes used in the business carried on in the building. The first step in inspection is the acquiring or making of a map of the premises, in which map arbitrary symbols are used to describe features of construction. The inspector must examine the surrounding and nearby buildings to determine the risk from exposure. The type of building, whether frame, mill, brick or fire-proof construction, must be considered. Next come wall, floor, ceiling, support material, unprotected metal or light masonry liable to be warped or fall from heat, openings in the floors, such as elevator shafts and stairways, concealed and inaccessible places, condition of the building, etc. He must investigate the occupancy, finding out the tenants, the parts of the building occupied, and the occupations carried on. The methods of heating and lighting and many other features, too numerous to mention, must be considered.*

The summary of the investigation is contained in the "survey" which is handed over to the rating department. This department is sometimes divided into two sections: the "mercantile department," which rates mercantile risks, and the "general hazard" department, which rates all other risks with a few exceptions. The survey is referred to the proper department and a rate computed according to the schedules and rules of the Exchange. A notice is published in the daily bulletin of the association, if it issues one, and the result

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§Similar laws exist now in several other States. See p. ——.

*For description of the inspector's work see E. R. Hardy, "Fire Insurance," pp. 42-51.

of the rating is supplied to all members in card form for filing in their rate cabinets. It is estimated that each member who operates in all of the territory of one of the large urban exchanges receives, annually, approximately 50,000 cards. The expense of the association for this service approaches $60,000 a year.

The policy having been issued at the rate promulgated, a copy or abstract thereof must be sent to the "stamping department." According to the rules of one association abstracts of all policies and endorsements must be submitted within seven days from the time they are written and must contain the following:

Name of company.
Number of policy.
Location of risk.
Term of insurance.
Kind of property.
Rate charged.
Kind of co-insurance clause.
Rate of brokerage.
Statement that all the rules of the association have been complied with.

If, after an examination, this abstract is approved, it is stamped "Correct" and returned. If "Incorrect" any errors to which attention is called must be corrected on the policy within two weeks.

Through the Committee on Rates the local association fixes either specific or minimum rates for the writing of insurance. A specific rate is a rate on an individual risk specified by location and description. A minimum rate is a rate for all risks of a same general description, such as dwellings. In the territory of a large exchange there are at least 300,000 buildings, and five-sixths of these are given minimum rates, such rates being based on the experience of the companies and the judgment of underwriters. Specific rates are arrived at by the use of schedules.

The rules of the association require that no policies shall be issued on risks until the latter have been rated by the Exchange. After a rate has been made no insurance shall be written at other than the official rate. This rule is frequently enforced by the establishment of stamping departments. Various minor regulations are enforced regarding rates, such as that they are binding upon the day they are promulgated, that when a change in hazard takes place the risk shall be re-surveyed and re-rated, that rates made upon contents apply only to the occupancy existing when the building is rated and the rate card must be re-published for each new tenant, that any error in rating is to be at once corrected without reference to the previous rating. Even the rates for terms of insurance of less than one year are controlled by some associations through the prescription of "short rate tables." Likewise "term rates," which give reductions for insurance of more than one year, are regulated.

One-sixth of all buildings, or about 50,000 in a large city, are rated by means of schedules. Schedules used in the United States are based upon

the principles of either the Dean (Analytic) or Universal Mercantile Schedules, with variations to suit local conditions. The New York Fire Insurance Exchange prescribes and uses schedules based upon the Universal Mercantile. The four following are the principal ones used:

(1) **The Green Schedule.** One which is used for rating non-fireproof hospitals, clubs, schools, stores, dwellings, apartments and tenements which are over the minimum height and area. A four-story building, for example, containing a drygoods store on the first floor and with the three upper floors in use as dwellings or apartments, would be rated under this schedule.

(2) **The Merchandise Schedule,** usually designated as the General Schedule. This is used for stores and dwellings which are of such a description that they would fall within the minimum rate class were it not for the fact that the first or grade floor contains an occupancy or business which excludes the risk from this class. Stables and garages are also rated by this schedule.

(3) **Universal Mercantile Schedule.** As its name indicates, this schedule is adapted primarily to the rating of buildings used solely for business purposes, other than heavy manufacturing. This schedule would be applied to retail and wholesale selling establishments and manufacturers of dress goods and clothing. A mercantile building with two or more floors occupied as dwellings would be rated, not by this schedule but by the Green Schedule.

(4) **The Manufacturing Schedule.** Such manufacturing risks as are not rated under the Mercantile Schedule would come under this schedule, and there would be included some printing, wood-working and metal-working establishments, and all serious manufacturing hazards. Certain other risks of a different nature are rated under this schedule, but it is unnecessary to enumerate them here.

In addition to the above there are used in rating as many as fifteen special schedules for special classes of risks, such as hotels, theatres, breweries, etc., these being known as "special hazards." For example, for certain manufacturing establishments protected by automatic sprinklers there is a Restricted Sprinkler Schedule.

The schedules for rating are, of course, the most important "forms" prescribed by local associations. In addition, however, they fix standard forms of co-insurance clauses, descriptive clauses, permissions, consequential damage clauses and many other endorsements or "riders." In this way the danger is avoided of having non-concurrent insurances upon the same risk, which situation may cause complications in the settlement of a loss which baffle experts.

The above description gives some idea of the nature, organization and objects of local associations of underwriters. They are voluntary associations of brokers and agents for the principal purposes of maintaining uniform rates of commission and brokerage and establishing a scientific, recognized system of fire insurance rating. The economic functions of sectional as well as local associations and the services they both render to the community will be described in a later section.

NATIONAL FIRE UNDERWRITERS' ASSOCIATIONS.

THE National Board of Fire Underwriters, membership in which is open to any stock fire insurance company doing business in the United States by election at a meeting or by action of its Executive Committee, was organized in 1866. There are now about 160 companies which are members. It was, until 1878, a rate-making organization; but since that time has exercised no jurisdiction over and is not concerned with rates, and is conducted along lines best designated as "educational and technical," having the following purposes:

First. To promote harmony, correct practices, and the principles of sound underwriting; to devise and give effect to measures for the protection of the common interests, and the promotion of such laws and regulations as will secure stability and solidity to capital employed in the business of fire insurance, and protect it against oppressive, unjust, and discriminative legislation.

Second. To repress incendiarism and arson by combining in suitable measures for the apprehension, conviction, and punishment of criminals guilty of that crime.

Third. To gather such statistics and establish such classification of hazards as may be for the interest of members.

Fourth. To secure the adoption of uniform and correct policy forms and clauses, and to endeavor to agree upon such rules and regulations in reference to the adjustment of losses as may be desirable and in the interest of all concerned.

Fifth. To influence the introduction of improved and safe methods of building construction, encourage the adoption of fire protective measures, secure efficient organization and equipment of fire departments with adequate and improved water systems, and establish rules designed to regulate all hazards constituting a menace to the business. Every member shall be in honor bound to co-operate with every other member to accomplish the desired objects and purposes of the Board.

The expenses of the Board are borne by assessments upon companies which are members in proportion to their net fire premiums in the United States, and are apportioned upon the receipts of the preceding year. The officers are a president, vice-president, secretary and treasurer, and the activities of the association, as of most underwriters' associations, are controlled by various committees, each of which devotes its attention to a particular field.

The Executive Committee consists of eleven elected members, and this is the governing body. It has power to fill vacancies occurring in its own ranks, to elect honorary members and to "exercise all necessary powers to promote the purposes of the Board." Its meetings are open to all companies members of the Board but not represented in the membership of the Committee. It appoints a general manager and such other salaried representatives and clerical help as may from time to time appear necessary.

Standing Committees are appointed by the president annually, of which the most important, for our purposes, are those described hereinafter. The work of the National Board may be best indicated by considering the activities of these committees.

The Finance Committee. It is the business of this committee to collect

assessments from members of the association in proportion to the net premiums received by such companies on business done in the United States. The percentage of such assessments for the year 1915 was 1/17 of 1 per cent. The expenditures of the Finance Committee may be classified under three heads:

(1) General expenses, which include the support of the Underwriters' Laboratories, cost of inspection, contributions to the National Fire Protection Association, and the expense of maintaining the National Board;

(2) Building construction expenses, including the salaries of engineers, printing and equipment;

(3) Fire prevention expenses, including the salaries of the field men, office force and printing.

The Committee on Laws. It is the duty of this Committee to obtain information of the various laws proposed affecting fire insurance interests; and in the past it was the custom to present at the annual meeting laws enacted during the current year, but arrangements have now been made whereby information is given to the members from time to time during the year of the laws proposed and the work of the Committee with a recapitulation annually of all laws introduced affecting directly the business.

Committee on Statistics and Origin of Fires. The functions of this Committee are clearly indicated by its title. In 1910-1911 it prepared a record of the fires and fire losses of cities in this and foreign countries which aroused widespread interest and was extensively quoted in addresses and in the insurance press. This work has been continued since that date. It annually prepares also a tabulation of large conflagrations as well as other tables of fire losses.

Committee on Incendiarism and Arson. This Committee has charge of the work of the Board in the prevention of and punishment for arson. During the year ending April 1, 1915, ninety rewards were offered, amounting to $28,550. As far as possible this Committee co-operates with the committees of various local underwriters' associations. There exists, in connection with this work, a permanent arson fund which is added to as necessary by assessments* upon the companies which are subscribers to the fund. The assessments amount to one-half cent for each $100 of net premiums, such assessments not to exceed in one year, however, one and one-half cents for each $100. Definite rules are laid down governing the payment of rewards for the conviction of incendiarism; but no rewards are to be paid to any officer or salaried employe of an insurance company, or to any public official, including an officer of police.

Committee on Fire Prevention. The work of inspecting cities for the purpose of ascertaining their facilities for protection against fire is in the hands of this Committee. This work has been carried on in its present form since 1904, and during that time reports have been issued on about 270 cities, many of which have been revisited after a lapse of five or six years to ascertain the extent of the changes and improvements. These reports contain a description of the water works systems, fire department organization and equipment, fire alarm systems and structural conditions and hazards; conclusions are presented

*No assessment of this character has been levied since 1905.

as to the adequacy and reliability of the various fire protection features, as well as an opinion as to the degree of the conflagration hazard, and recommendations are made for improvements in the different departments. For the past three or four years the tests of fire engines exhibited at the Conventions of the International Association of Fire Engineers have been conducted by the engineers of the National Board. Engineers have been assigned, on request, to advise as to the necessary fire protection facilities in some of the government buildings in Washington and for the Panama-Pacific Exposition in San Francisco; one of the National Board engineers was engaged, while on leave of absence, to supervise the design and installation of the fire protection at the Exposition, and another is similarly engaged on the installation of a high-pressure fire system in Boston. Much time is employed by the engineers in preparing public laws and ordinances relating to fire prevention, many municipalities calling upon the Board for assistance in framing such ordinances when necessary. In various ways this Committee co-operates with local boards of underwriters, associations of engineers, associations of credit men, and all who are interested in the reduction of fire losses.

Committee on Lighting, Heating and Engineering Standards. The National Board, through this Committee, prints standard specifications for the installation of protective devices, such as signaling systems, municipal fire alarm systems, fire pumps, and similar appliances. It likewise prints specifications for the installing of electrical systems and furnishes such rules and specifications as have been named to various associations, bureaus and the public, not as orders, but as suggestions representing the best thought of technical experts of the insurance profession. It is by such acts as these that the educational character of the National Board is most clearly recognized, and it is unfortunate that the public does not more fully realize the value of the service which is thus freely rendered; but most of the improvements in property come rather by reason of the insured's self-interest in a financial way than through enlightenment by education. In other words, the increased premium charge on poor risks is a greater incentive to good construction than a vast amount of education.

Committee on Construction of Buildings. The object of this Committee is the improvement of building construction in the United States. One of the greatest steps in this direction was the preparation of the National Building Code. Thousands of copies of this work have been distributed, and many municipalities in the country have prepared or revised their building ordinances on the basis of that Code. The Code has recently been completely revised so that in effect it is practically a new ordinance. Its engineering and fire protection features have been brought into accord with best present-day practice and it is now the recognized standard for safe building construction.

The Committee maintains an expert service upon all matters relating to the drafting of building ordinances and fire-resistive construction. It is ready at all times to aid municipal or State authorities with advice in relation to laws dealing with those subjects. Such work is constantly in progress and very beneficial results have been obtained.

The work is distinctly educational in character, and it is evident that the work of this Committee is already producing a material, beneficial effect upon the character of building construction throughout the country, yet it is recognized by the Board that a full realization of the protection to be derived from reduction of the conflagration hazard will not be attained for some years. This is because new laws for the most part regulate new buildings, and can do little in the way of removing the hazard of existing structures.

Committee on Adjustments. The endeavors of this Committee are in the direction of facilitating the adjustment of losses. As an example of its work, one might mention the preparation of an emergency equipment to be used for the benefit of all companies in case of a large conflagration and consisting of "a cabinet with suitable cards, folders, indices, etc., to aid in at once organizing a bureau to tabulate property destroyed or damaged, to list claims, companies interested, committees appointed, dispositions of claims, and to keep watch on fraudulent or dual claims." This is based upon the experience gained in the large conflagrations of the past, the idea being to put such experience in a form available for future guidance, if necessary.

The Underwriters' Laboratories. The description of National Associations must also include some mention of the Underwriters' Laboratories, a corporation formed by the National Board of Fire Underwriters in 1902, the entire capital stock having been subscribed for by members of the latter body. The excellent fireproof buildings of this concern in themselves are incentives to better construction, combustible material having been entirely eliminated from them, the very highest skill in fire protection having been employed in their construction, and their internal fire defenses being the best that modern science can afford. The purpose of the institution is best expressed in its own language:

"The object of Underwriters' Laboratories is to bring to the user the best obtainable opinion on the merits or demerits of appliances in respect to the fire hazards. Such appliances include those designed to aid in extinguishing fire, such as automatic sprinklers, pumps, hand fire appliances, hose, hydrants, nozzles, valves, etc.; materials and devices designed to retard the spread of fire, such as structural methods and materials, fire-doors and shutters, fire-windows, etc.; and machines and fittings which may be instrumental in causing a fire, such as gas and oil appliances, electrical fittings, chemicals and the various machines and appurtenances used in lighting and heating."

After a device or material has been tested the report of such test is submitted to the Council of Underwriters' Laboratories, which consists of twenty-two members, all directly interested in fire protection work or underwriting associations and representing all sections of the United States and Canada. If the article is approved, it is then listed as an approved and satisfactory article, either direct by the Laboratories' card system to subscribers or through the National Board's periodical list of appliances.

Actuarial Bureau Committee.* What probably is the most important work

*For a description of the work thus far completed by the Committee see Robert Riegel, "Co-operation and Classification in Fire Insurance," Quarterly Journal of Economics, August, 1916.

undertaken in recent years by the National Board was the inauguration of what is known as the "Actuarial Bureau of the National Board of Fire Underwriters." The purpose of this work is the compilation of statistics to the end that a complete and carefully compiled record of all fire losses upon insured property in the United States may be obtained, with full information regarding occupancy, location and character of property, values, insurance, origin of fire, etc., and for the investigation of the fire dangers to which each class of property is subject, and the development of thorough and scientific information concerning the causes of fire and their prevention.

The plan for this work was completed during the year 1914, and the Bureau began active work January 1, 1915, and has since that date collected and classified approximately 500,000 reports of losses which have been paid by the various companies during the year 1915.

The entire affairs of the Bureau are under the charge of a standing committee known as the Actuarial Bureau Committee, which, as other standing committees of the Board, is under the supervision of the Executive Committee, it being understood that the Actuarial Bureau Committee has full power to make such incidental changes as are necessary to perfect the system of classification, all changes subject to the final approval of the Executive Committee.

The expenses of the Bureau are met by an assessment by the companies subscribing to its support and are based upon the gross premiums less only cancelation. This work is open to all fire insurance companies of every kind, and includes in its membership not only the National Board companies, but non-Board companies and mutuals.

It was evident that this, the first year, would be needed for bringing the operation of the loss department into proper method and order, leaving little or no opportunity for taking up the question of writings, and for that reason the compilation of writings was deferred and will not be undertaken until the first day of January, 1916.

The National Fire Protection Association.† About seventeen years ago there was formed the National Fire Protection Association, the aims of which are stated to be:

(1) To promote the science and improve the methods of fire protection and prevention;

(2) To obtain and circulate information on these subjects, and,

(3) To secure the co-operation of its members in establishing proper safeguards against loss of life and property by fire.

The membership of this body is divided into three classes. National institutions, societies and organizations interested in the protection of life and property against loss by fire, State associations whose principal object is the reduction of fire waste, and insurance boards and associations having primary

†National Fire Protection Association, "The Work of the National Fire Protection Association."

jurisdiction are eligible for active membership. Associate members are national, State and municipal departments, chambers of commerce, business men's associations and individuals engaged in the fire insurance business. Subscribing members are those who receive the publications of the association. When a person wants to know how to make a standard fire-door or the correct method of installing a gasoline engine he goes to the office of the nearest underwriters' association, where he may obtain a pamphlet containing the information desired. At least thirty-seven subjects are covered, these specifications having been drawn by the members of the National Fire Protection Association. In acknowledging its indebtedness to the experts who contributed, the Association states: "There is no public effort in the history of the Nation to which there has been so freely given over so long a period so much expert thought and painstaking technical investigation as to the National Fire Protection Association." While the connection of the National Board with the National Fire Protection Association is one of membership only, they are concerned in its activities inasmuch as they are principally those of fire protection and prevention.

Services of National Associations.

From the foregoing description we may summarize the services of national associations of the type considered as follows:

1. They educate the public to an understanding of the value of insurance in the reduction of risk.

2. They bring about harmonious co-operation of fire companies and underwriters toward aims broader than mere indemnity for loss.

3. They have reduced various expenses which the insured ultimately, of course, pays, such as:

   (a) Expense of watching legislation.
   (b) Expense of protesting against unjust laws.
   (c) Expense of reducing arson.

The effectiveness of efforts along these lines has been correspondingly increased.

4. They have compiled and published statistics of the insurance business which are recognized as standard—the National Board Tables—and have made instructive comparisons of data.

5. They have endeavored to reduce arson and incendiarism.

6. They have inspected, criticized and suggested improvements in the protective facilities of cities and towns.

7. They have furnished consulting engineers to assist in all kinds of construction, to give advice on apparatus and ordinances.

8. They have set up standards for the installation of lighting and heating devices.

9. They have formulated codes as guides to correct building.

10. They have improved methods of adjusting losses.

11. They have been largely instrumental in causing the adoption of a standard fire policy and have formulated standard forms and clauses.

12. They have tested and inspected fire preventive and protective devices of all kinds and have established a standard of efficiency for such devices.

13. Last, but not least, they have been the greatest factor in educating the public to the fact that reduction in fire losses means reduction in insurance premiums, and that the latter is principally dependent on the former.

It must be admitted that the above is only a partial list of the services rendered by these organizations, yet it is hoped that it is sufficient to show the benefits derived from their existence by the public, supported though they are principally by private capital. Their very existence is sufficient to show that insurance companies and underwriters are not concerned wholly with furnishing indemnity and profits and losses, but perform other real and useful services to society. While indemnity for loss is an indirect and negative service of insurance, the above presents another aspect of the business, showing results which, while indirect, are yet positive in character.

SECTIONAL ASSOCIATIONS OF FIRE UNDERWRITERS.

A SECTIONAL fire underwriters' association is a voluntary organization of company representatives having jurisdiction over a number of States, as distinguished from local bodies which control only single cities and national associations which are of a technical and educational nature. The sectional association partakes of the nature of both local and national associations in that it performs work of a technical nature, endeavors to reduce fire waste, regulates commissions and influences fire insurance rates. But while control of rates is the primary function of local bodies and technical work of national bodies, the sectional associations' principal object now is the reduction of the expense of the business by control of commissions.

The Eastern Union.

The Eastern Union is an example of the sectional type of organization, and "is composed of fifty or more of the larger and stronger fire insurance companies—both American and foreign—doing a fire insurance business in the United States."* Any company may apply or be proposed for membership, but must be elected by a majority of the members present at a regular meeting. All members are, of course, required to subscribe to the constitution and by-laws of the association. It is stated that in this association no penalties or fines exist to bind the members, a sense of honor to associates being the only tie.

Its influence, exerted through the executive officers of constituent companies, extends throughout the Atlantic and Gulf Coast States, except where prohibited by law.† This influence may be described best by an outline of the functions of the Union. It "is organized for the purpose of maintaining, by all proper and legal methods, correct practices in the business of fire insurance;

*The greater part of the information secured on the Eastern Union was obtained from a letter by Mr. Henry E. Rees, former President of the Union.

†Anti-compact or "anti-trust" laws.

the reduction of the expense of the business by controlling, where permitted to do so by law, the compensation paid to agents and brokers, keeping always in mind that the expense of doing business is necessarily a part of the rate of premium and must, in the end, be borne by the insuring public."

Another object is "the systematic inter-change of information by which all members are benefited, and a practical co-operation by inter-insurances, by which agents of Union members are assisted in retaining in their offices large line risks which would otherwise be sought for, and probably written, by the broker in a distant city."‡

"The Union encourages superior fire-resisting construction, the introduction of modern fire protection appliances in city and individual plants, thus endeavoring to do its share toward the reduction of the per capita fire loss of this country, which is large when compared with the older countries of Europe."§ Thus it is apparent that educational and technical services are not confined to national associations, although such services are the vital purpose of the latter.

The Union also has some influence over fire rates, but in many cases this is only indirectly exerted. It may, for example, appeal to a local association to raise its rates; and its influence is usually sufficient to accomplish the desired object. No direct connection between the Eastern Union and rates has been discovered.

It must be recognized that the Union companies may also have representatives in local associations. The Union is an association of companies, and not of brokers and agents, and the interests of the two may be directly opposed, as in fact they usually are, on the subject of commissions. It is the practice of many of the non-Union companies to offer an increased commission to the agent in order to compete with the Union companies, who have combined for the purpose, as stated, of reducing expenses. Competition of this nature was recently so intense as to force the Eastern Union to the verge of dissolution and compel that body to raise their commissions to the graded scale granted by the Western Union. Previously the commission had been restricted to a flat 15 per cent. There are, however, in the Union territory, certain excepted cities, where no limit is placed by the associations upon commissions, which have reached at times as much as 45 per cent. This high rate is a tribute to entrenched monopoly which the companies would like to dispense with. It would seem that some restriction should, if only in the interest of the policy-holder, be placed upon the rate of commission, which is a large factor in the expense account and consequently in the premium.

The rules of the local organizations regarding commissions are influenced to a large extent by the Eastern Union. The Executive Committee of the Boston Board of Fire Underwriters, for example, recently made changes in the rules after conference with the Eastern Union representatives. As Mr. J. B. Kremer expresses it, "while the several associations in charge of this territory"

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‡See "Western Union—Regulation of Agents," p. 28.

§Letter to the author by Mr. Henry E. Rees, former President of the Eastern Union.

(the South and East) "are independent of it, its influence is such that over them it has what may be termed a paternal watchfulness."[1]

The Western Union.

The report of the National Board of Fire Underwriters for the year 1879 contained the following paragraph:

> "One ..... effort ..... this ..... year has thus far proved a success, i. e., the development of what is known as the Western Union, an organization ..... having for its object the formation of local boards throughout the States governed by its rules. Their chief province is the equalization of rates, to be made not excessive, but adequate to the hazards carried."

This association has, therefore, been in existence more than thirty years, being a result of the National Board's relinquishment of rating power. At the time of its organization, it comprised about one-half of the general agency companies, the number being made up mostly of the strong and conservative, and this has remained the character of the membership until this date. Its authority extends over about twenty States of the Middle West.

As the agency system gradually developed between 1850 and 1872, Chicago most naturally became the location of the Middle Western general agencies. In 1872 there had been established in Detroit "The Western Association of Insurance Managers," but the failure of this association to suppress the demoralizing practices of hazardous underwriting and reckless rate-cutting gave occasion for the formation in 1879 of the "Western Union." Membership then was and now is confined to company officials, and its principal object has always been to regulate commissions, although it has established many local boards and has made rates. The most important issue of the Union soon became the demand for a flat 15 per cent commission to agents.

The method of government is similar to that of nearly all associations, the appointment of committees, among which are the Governing Committee, the Technical Committee, and the Committee on Publicity. The Governing Committee promotes agreement between members, and takes charge of the affairs of the association between meetings. Recently, for example, an agreement for co-operation was made, and having been found to work satisfactorily, the Governing Committee decided to extend its scope. It has supervision over rates, is the ruling body in the association, and in many cases acts as the representative of various constituent companies in adjusting matters with insurance commissioners and other State officials. It maintains stamping departments, grants relief from published rates and supervises some rates. It may make agreements on behalf of the Union with other organizations.

The Technical Committee need not be described here at length, since its work is of an educational and fire-preventive character, and these functions were more fully discussed in the section dealing with the National Board. This

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[1] J. B. Kremer, "The Agency," address before the ninety-first meeting of the Insurance Society of New York.

committee, for example, will investigate the fire protection facilities of various cities, and make a report of conditions. Such a report may be the basis for a recommendation of increase in the rates of the backward communities.

The object of the Committee on Publicity is to secure the co-operation of insurance commissioners, fire marshals and commercial associations in educating the public regarding the general principles of fire insurance, and the necessity for the reduction of the fire waste. Literature is sent out by a publicity bureau with the intention of stimulating the interest of those whom it is desired to reach. While results have been attained, the work has not received the success it deserves, because the territory in which the Union operates is one which is regarded as generally hostile to insurance associations and their work.

The Territory of the Union.—The jurisdiction of the Western Union extends over the territory bounded on the east by Pennsylvania, West Virginia, Virginia and North Carolina, on the south by Georgia, Alabama, Mississippi, Arkansas and Texas, on the west by Arizona, Utah, Idaho and Montana, and by Canada on the north. At the time of its organization, the plan was rejected by some powerful agency interests in a few large cities, and these cities have since remained independent, being known as "excepted cities."

The Functions of the Union.—The principal object of the association is to reduce the expenses of companies by the restriction of commissions paid to agents. When the association was organized the principle contended for was a flat 15 per cent commission, and for some years this principle was maintained. But gradually non-Union companies, by the payment of higher commissions, secured the preferred business. The constant loss of good risks finally compelled the Union to establish graded commissions, 25 per cent on preferred risks, 20 per cent on brick mercantile buildings, and 15 per cent on other classes. These commissions were allowed only to agents representing Union companies, and in mixed agencies (representing both Union and non-Union) only 15 per cent was allowed. In the excepted cities mentioned the commissions are open and sometimes run very much higher. The necessity for some organization or influence to restrict commissions is evident from the fact that the non-Union companies "competed" with each other until conditions were unbearable. They then formed another association, known as the Western Insurance Bureau, with exactly the same purpose as the one they refused to join or withdrew from, and established a scale of graded commissions somewhat higher than the Western Union.

Rates.—The connection of the Western Union with rates is indirect in character. Where independent raters work, the Union appears to act in an advisory capacity. It tries to have its members maintain the rates published, and has stamping departments for this purpose where legally permitted. This department advises the companies of the proper rates and of any changes in the rates. Abstracts of the daily reports are sent to it, and the correct rate, whether it has been obtained or not, is stamped upon the abstract.

The rules provide that "no insurance, either direct or by re-insurance, shall be effected in any manner whatsoever at a rate below the tariff" unless as elsewhere provided for by the rules. If the correct rate is violated the punishment

is loss of good will among the members and expulsion from the Union. This penalty involves, of course, an entire readjustment of the offending person's business. If it is necessary to write the risks at a rate lower than the published rate, a relief rule must be passed by the Governing Committee, allowing a reduction. The Union prescribes the risks which may be given term rates. Its rules were several years ago extended to brick mercantile buildings, and at a recent meeting the subject of term rates was discussed.

The Union tries to form and maintain local boards in the various States it covers, through traveling agents who get in contact with local agents. This work is under the control of the Governing Committee. It has an agreement with the Western Insurance Bureau, a rival organization, under which companies require agents to settle for premiums received within forty-five days from the end of the month in which the risk is written. Agents try to use the non-Union companies to make the rule ineffective. There is also a co-operative agreement between these two bodies, regarding the status of agencies.

Inasmuch as the territory of this association includes several States, the rates which agents are required to maintain are arrived at and enforced in various ways, the method varying with the laws of different States. In some instances, the rates are made by the local associations established under the influence of the Union. Other rates are made by State Inspection Bureaus, to whom the work of rating has been delegated by the Governing Committee of the Union, which retains supervision over the same. The inspection bureaus employ their own men to perform the work. Whenever the State laws will permit local boards are organized unless inspection bureaus already exist. No reductions in rates are to be made by members of the Union until such reduction has been promulgated by the recognized rating authority.

From the above it will be evident that the Western Union (1) acts in a supervisory manner toward rates, and endeavors to insure the maintenance of the rates and rules promulgated by the various recognized authorities; and (2) attempts to establish recognized rating systems where none exist. Complaints of violations of the established rates are treated in the manner described under "Regulation of Brokers and Agents."

Establishment of Inspection Bureaus and Local Boards.—The rules state that "wherever the State laws will permit, the Union *will require*‖ agents to organize local associations, (except at places which are within the control of inspection bureaus now existing or to be hereafter established) for the purpose of establishing an equitable and discriminating tariff of rates for their respective localities, under the supervision of State boards and the governing committee * * * ." Where such local boards are formed, their expenses must be borne by members on a pro rata basis of premium receipts. Members of the Union are forbidden to pay assessments levied on any other basis.

Local boards and inspection bureaus may try members for violations of their rules and punish as provided by such rules for the first or second offense, but upon a third conviction, with the approval and order of the Governing

‖Italics are the author's.

Committee, all members of the Union represented by such agent shall withdraw their agencies from him and he shall be thereafter ineligible for any agency appointment until reinstated by the Governing Committee. An agent not amenable to discipline is thereby "blacklisted." The Union lays upon its members the duty of seeing that their agents obey the rules and regulations of the local bodies unless the same contravene those of the Union, in which case the Union rules shall govern. Any member may, however, appeal to the Governing Committee from a penalty imposed on its agent by a local board within thirty days of the imposition. This Committee holds a hearing and renders a final decision.

Regulation of Agents.—It has already been stated that the rules require the agents and brokers to observe the published rates and even the rates of non-Union companies and provide penalties for failure to do so. Rebates of commissions to the insured or any person in his interest are strictly prohibited in every form, and no member is permitted to take a line of insurance, or any part thereof, from one who indulges in such practices, even though the portion offered such member shall have been written in accordance with the rules. Where a complaint of rebating is made to the Governing Committee, the member writing the line in question must satisfy the Committee that the insurance written involved no rebate. It is the duty of the Committee to investigate such complaints and rule in the matter. Appeal from its decision to the Grievance Committee may be made within ten days, but the decision of this latter Committee is final and may be enforced by suspension or forfeiture of membership.

The rules provide that companies shall not reinsure others which are not members of the Union, in any manner whatsoever, except a non-Union company retiring from business in Union territory. Companies are also required to prevent their agents from inducing a local agent to represent their company in place of another Union member which such local agent previously represented. Companies represented in the Union must not be represented by the employes of any non-Union companies, except if such non-Union companies be adhering strictly to Union rules or if local companies, to the rules of the local boards having jurisdiction.

Commissions.—The Union, although originally desiring to enforce a 15 per cent commission on all classes of risks, has been forced to recognize the graded commission plan, and also the rival Western Insurance Bureau, the organization of which has been described. Western Union companies, therefore, are permitted to pay certain graded commissions (i. e., commissions varying with the class of risk) as agreed upon in the Conference Agreement of April 6, 1912, with the Western Insurance Bureau. Both associations agree to avoid being represented by agents who also represent companies paying excessive commissions, i. e., non-Union and non-Bureau companies. Provisions are made for determining the status of any agency as either a Union, Bureau or mixed agency. In addition to the work of organizing local boards and inspection bureaus, supervising rate-making, and regulating agents, the Union promulgates rules governing the practice of the business, which prescribe forms to be used, designate term risks, enumerate conditions for writ-

ing sprinklered risks, prohibit the waiver of certain policy clauses and prescribe a short rate table.

The influence and power of these sectional organizations, and the extent to which they foster concerted action by insurance companies, which is often to the public benefit, is well illustrated by what was termed by the press during 1913 as the "Missouri situation." The State of Missouri, after compelling insurance companies to file their rates with the Insurance Commissioner of the State for his approval, and ordering many risks to be re-rated, which the companies were permitted to do through common agencies, passed an exceedingly drastic anti-compact law. This law provided that no combinations of insurance companies should be effected for the purpose of making rates, and that the use by a company's representative of any rate or rate-book "prepared, kept or furnished" by any person acting in behalf of any other insurance company was prima facie evidence of such combination. Heavy penalties were imposed for violation of this provision. After fruitless attempts by various insurance interests to adjust matters, the Western Union held a meeting in April, 1913, at which the question was considered. Although the Union could not act as such, fearing legal action against it, the companies composing the same individually all agreed to cease writing insurance in the State of Missouri after April 30, claiming that business could not be carried on under the new act's provisions. This caused tremendous disturbance in all businesses involving credit, to which insurance is necessary, and the State authorities were finally compelled to agree that the law would not be enforced. It might be added that the Western Insurance Bureau also pledged similar action by its members.

Summarizing the above it may be said that sectional organizations attempt to perform, in a broader and looser manner, the functions undertaken by local associations. In the first place they exercise an influence over rates: (a) by endeavoring to insure the maintenance of those promulgated by various recognized authorities such as local associations, "independent" raters and inspection bureaus; (b) by efforts to establish recognized rating systems. Secondly, they endeavor to reduce the large annual destruction of property by fire. Thirdly, they regulate the actions of insurers as regards rebates, reinsurance, short and long term rates, endorsements on policies and with respect to great emergencies such as the Missouri situation. Fourthly, they regulate the expenses of doing business as far as commissions are concerned.

ECONOMIC FUNCTIONS OF FIRE UNDERWRITERS' ASSOCIATIONS

NOTWITHSTANDING considerable criticism and many statutes directed against them,* it must be plain from the description in preceding sections that underwriters' associations, far from being inimical to the public welfare, really possess economic functions and are a necessary part of the insurance system as at present constituted. If the contentions of their

*See article by the author, "Commonwealth vs. Co-operation," in THE MARKET WORLD AND CHRONICLE, June 12, 1915.

critics be examined it will be found that the faults of the exchanges are not sins of commission, but, at the very worst, sins of omission. Combination and association have not gone far enough and have failed to completely attain their purposes. This is not said to "whitewash" any associations which may have abused their power or to compromise with any acts which deserve to be condemned. But, while it has been a general practice to bring to light the delinquencies of this system of co-operation, no real effort has been made to present its desirable features. It is intended to summarize here the more important services of such organizations.

(1) Such organizations offer to insurance men a chance to become acquainted with their competitors, and it will be generally admitted that such acquaintance improves the moral tone of any business. Many who would unhesitatingly take undue advantage of a stranger—witness the attitude, for instance, that it is perfectly proper to cheat a corporation—regard it as dishonorable to meet an acquaintance in any but an open manner. In other words, through the medium of the association a bitter struggle with enemies is converted into friendly rivalry. Many objectionable practices are thus indirectly eliminated.

(2) New problems arise in the insurance business every day. Under circumstances where the interests of agents and brokers do not conflict, where they are not enemies awaiting every opportunity to out-distance a competitor, where they operate according to a well-established code of rules, these new problems are more likely to be discussed in a fair and open way, and the combination of two or more minds will more probable arrive at a correct and equitable solution of any difficulty than will individuals thinking independently. For individual opinion there is substituted mutual counsel and concerted action by means of associations. For example, how could a rating schedule be adapted to local conditions except by the concerted action of experts? How could an adequate and just scale of commissions be otherwise adopted? How could it be decided whether or not certain acts were detrimental to the business as a whole?

(3) From time to time legislation is enacted which is prejudicial alike to the insurers and the public. As an instance may be cited valued policy laws which sometimes compel insurance companies to pay the insured more for his property than its value at the time of the fire and thus encourage destruction of property. Also may be mentioned retaliatory laws, whereby one State taxes heavily the insurance companies of another. The second retaliates, and so on—the insurance companies and ultimately the insured paying the cost of this war of statutes. Against such legislation protection is required; and it cannot be obtained by individual action. Singly, insurance companies, because of popular ignorance of the business, are at the mercy of any laws which may be enacted, without hope of public support. A protective alliance is the only defense available. When, as in Missouri, the law one year permits companies in common to employ an expert to make rates and the next year makes a combination of this kind a penitentiary offense, single companies alone are powerless, but concerted group action may force a more just exercise of State power.

(4) Judicial procedure in the United States is notoriously slow. In many businesses associations exist to prevent dealers who refuse to abide by business ethics from transacting business with honest men. Thus the New York Stock Exchange has the power to exclude from its floor any broker whose acts are inconsistent with business principles without waiting for a court decision which may not be delivered for several years. In the same way the underwriters' associations afford a means of ridding the business of objectionable persons. About a year ago, for example, a certain political "boss" was refused admission to one association because of his general reputation. That an association's power in this respect is capable of abuse cannot be denied, but its proper exercise is apparently serviceable to the community.

(5) It is probable that nothing has had so much influence upon the development of a scientific method of rating as associations of underwriters. Prior to the adoption of the Universal Mercantile Schedule no very generally accepted system of rating existed. After the issuance of this schedule, which itself was but an evolution of more or less crude schedules promulgated by the older local associations, the schedule principle was further improved by such associations and adapted to the requirements of practically all localities. Mr. C. A. Hexamer said in this connection, in an able article: "I will, therefore, confine myself to the history of the development of * * * the Philadelphia Fire Underwriters' Association, believing that in the development of that organization all of the various advancements in scientific rate-making can be clearly traced."‡ This association began in 1852. It promulgated later "Classes of Hazards and Rates of Premium in the City of Philadelphia," which list was based upon principles still in use and was the beginning of the present system. The Underwriters' Association of New York State was formed in 1883 and the National Board of Fire Underwriters in 1866. Practically all of the larger associations in the East have been in existence prior to the adoption of the schedules in use to-day, and it is natural to expect that schedules requiring combined opinions of underwriters should develop from organizations fostering acquaintance, mutual counsel and co-operation.

(6) Of the advantages of combined action in rating and inspection much might be said, but a brief illustration must suffice. Let us suppose that in a given territory there are 40,000 insurable mercantile and manufacturing risks. Inspections entailing expense are necessary. There are, we will say, fifty insurance companies in the field and each risk, on the average, is insured in two companies. It is frequently the case that large risks are divided between four or five companies. There are, therefore, 80,000 insurances and, if no co-operation exists, 80,000 inspections and ratings. Arbitrarily assuming the cost of each to be $5, the expenditure is $400,000, an expense which must, of course, ultimately be borne by the policyholder. If the companies combine to do this work the 40,000 buildings are rated once at a cost of $200,000 and the results are available to all at one-half the alternative cost. Every member of the association or rating bureau receives his card covering each risk. It

‡"Rates and Schedule Rating," Annals of American Academy of Pol. and Soc. Science: title, "Insurance," September, 1905.

is apparent that the extent of the saving is dependent upon the number of insurances upon the same building and number of times inspections and reinspections are required.

(7) The above figuring does not adequately measure the savings, since no account has been taken of that reduction of expense which naturally follows combination, due to specialization and division of labor.

(8) When a number of companies pool their facilities to obtain a rate it must be admitted that the result is more probably just and adequate than where the charge is the result of or is influenced by competition; and adequate rates which are not exorbitant are to the interest of both the public and the insurer. It is impossible for ruinous competition in the insurance business to prove of any lasting advantage to the policyholder. In most other businesses, the result of competition among producers or distributors is an advantage, more or less permanent, to the consumer. In purchasing insurance, however, it is impossible for him to receive the same article at the reduced price. The commodity he purchases is not delivered to him at once, but over a term of one year, three years or five years. If the price is reduced by 25 per cent the stability of the selling company is reduced, and this stability is the only guarantee that the consumer will receive the protection he paid for. The company, in other words, after the advance payment of the premium stands in the position of debtor to the insured, and it is to the advantage of the latter to have it in as good financial condition as possible. Adequate rates are, therefore, to the common interest, and in bringing them about the associations render a service to all.

(9) While authorities are divided on the question of the necessity of classification of loss statistics in the fixing of rates, if such statistics are of value the underwriters' association presents itself as a medium (and, indeed, the only practical one) for obtaining such data. In fact, in the opinion of one investigator of the subject,§ "effective measures should be adopted in order to enable the exchange to obtain the experience of companies on the various classes rated by it." Recently the idea of using classified loss data as a basis for rates seems to have the ascendancy and the National Board has a committee working on this problem at the present time.

(10) It is and has been for some time the practice of insurance companies to consider one year as the standard policy term and to charge proportionately for insurance of less than one year. Rates for terms shorter than one year are known as "short rates." Originally companies charged what they liked for short term insurances. Later, a little uniformity was attained but was sacrificed when such a course seemed desirable. Now, however, all the companies of the Middle West adhere to the short rate table of the Western Union and many local organizations have established tables which coincide. Likewise, it has been the practice very generally to make some reduction proportionately in the premium for insurance taken for short terms of three and five years. These reduced rates apply only to certain classes of

§S. Deutschberger, "Report on Examination of New York Fire Insurance Exchange," July 21, 1913. New York Insurance Department.

risks and are called "term rates." No uniformity exists whatever regarding the classes of property which may receive term rates except such as is imposed by the underwriters' associations. Thus it is evident that such associations have promoted uniformity as regards short and long term rates.

(11) A fire insurance premium is in the nature of a tax and all taxes are based upon uniform assessments of the same percentage of value. Likewise, insurance rates are based upon the supposition that all will insure at least a certain percentage of the value of their property. The majority of losses by fire are small. Therefore, other things being equal, the property owner who insures a proper percentage of his property's value is entitled to a lower rate than one who insures a small percentage. There is a difference between the cost of insuring different percentages of value even greater than the difference between wholesale and retail prices in mercantile business. Co-operation of companies is necessary to provide for this by percentage coinsurance clauses in all policies, or general adjustments of the rate.

(12) It is probably necessary only to mention the work of the association in raising the standards of building construction and rendering lives, houses and factories less liable to destruction. The work of the national organizations along this line has been described. The efforts of State, sectional and local bodies must not be forgotten. The importance of these efforts to reduce fire waste is apparent when we consider that the loss per capita by fire in the United States is ten times that in many European countries. Mr. Willis O. Robb, manager of the New York Fire Insurance Exchange, says: "The Exchange has done almost more than any other agency both to improve the quality of so-called fire-proof construction, by charging for defects, and to encourage by its very low fire-proof building rates, the multiplication of standard fire-proof structures and the breaking up of great areas of conflagration breeders. The difference between properly and improperly protected columns and beams is one that architects and owners have largely learned from underwriters, whose knowledge has been put before them in the persuasive form of discriminating rates. It is now a common practice for architects to submit plans for new buildings and improvements to the Exchange for comment and criticism, and in order to secure advance information as to the probable rates."¶ The inspections of the Association of the Middle Department, for example, of smaller towns and cities, have resulted in many improvements. Engineers are supplied who give gratuitous service, and other activities along this line have been described elsewhere.

(13) Along with the efforts to better building construction go the services rendered in standardizing and improving protective and preventive devices. This work has been described in the consideration of the functions of the National Board and the National Fire Protection Association, and is only mentioned here to make the list of services as complete as possible.

The report on the Examination of the New York Fire Insurance Exchange

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¶W. O. Robb: "New York Fire Insurance Exchange," Popular Insurance Magazine February, 1911.

states:‖ "There can be no doubt that the practice maintained from the first by the Exchange of including in its rates a charge for defective water supply and fire protection and making prompt allowance for betterments in these respects, has contributed largely to the improvement in fire protection, both public and private, that has been so marked a feature of the recent history of New York."

(14) In addition to the co-insurance clause previously mentioned, the value of the standardization of other forms of clauses and endorsements should be noted. If the value of a standard fire policy be acknowledged, it follows that similar, though lesser, benefits must result from uniform clauses. The legal meaning of various words and phrases becomes fixed, the underwriter knows definitely what privilege he is giving and the policyholder what benefit he is receiving.

(15) Underwriters' associations are a great influence toward economy. We have already mentioned the saving in expense of rating by means of co-operation, and there is also a saving in other items. In an era of competition, an increase in commissions to agents and brokers is almost as effective as a decrease in rates. By means of the regulations of associations excessive commissions are eliminated. The rules of the associations also provide against the evils of the rebate, which entails a preference of one policyholder over another. In other words, fire insurance companies, through associations, have themselves abolished an evil which in the railroad business required the intervention of the Federal Government.

A synopsis of these economic functions will serve to place them more clearly in mind. The services of underwriters' associations may be grouped as:

I. Those regarding *economy*:
   - (A) In the making of rates:
     - (a) by the saving in labor and expense;
     - (b) by specialization and division of labor.
   - (B) In commissions.
   - (C) In surveillance over legislation.

II. Those regarding *standardization*:
   - (A) Of rates and rating systems:
     - (a) by the improvement of schedules;
     - (b) by the establishment of organizations to apply the schedules;
     - (c) by the elimination of rate-cutting;
     - (d) by the classification of loss statistics.
   - (B) Of long-term rates.
   - (C) Of short-term rates.
   - (D) Of clauses and endorsements.

III. General results:
   - (A) Elimination of objectionable practices:
     - (a) by acquaintance;

‖Pp. 123-124, New York Insurance Department, July 21, 1913.

(b) by prohibition of rebates;
(c) by expulsion of undesirable members.
(B) Mutual counsel and assistance.
(C) Surveillance over legislation.
(D) Prevention of and protection against fire.

Like many supposed evil combinations such associations prove upon examination to be really of assistance to the insurance consumer, if that term can be applied to the holder of a fire policy. Their services in connection with economy and standardization entitled them to be recognized generally as institutions with certain very proper functions, with individual instances of bad practices and abuse of power. In this light the proper object of any legislation is very plain, namely, to retain the advantages of such associations and to eliminate any undesirable features. This is to regulate. Regardless of the seemingly plain necessity of such a course, however, for many years our legislatures have pursued the course of hostility toward co-operation, of prohibition of combination. The companies have been proceeded against under general anti-trust laws applicable to all industries, under the common law, under specific anti-trust statutes naming insurance and other businesses in particular and under State-rating acts. With the exception of instances where the mere filing of rates is required, only two or three of our States have recognized the principle of regulation. In a few other States the advantages of co-operation are admitted but quite unconsciously and only under State administration of the rating facilities. Yet after so many years and so general a trial no success can be claimed for the prohibitory variety of legislation.

CAUSES OF LEGISLATION AGAINST FIRE UNDERWRITERS' ASSOCIATIONS

A STUDY of fire underwriters' associations makes two facts very apparent—(1) that they have certain very definite economic functions and a place in the present insurance system, and (2) that notwithstanding this, the public has become opposed to them and legislation has endeavored to suppress them. The services of these associations have been enumerated in a previous section,[1] and the extent of the antipathy to this form of organization may be judged by the number of investigations, prohibitory statutes and prosecutions. Fire insurance investigations have been conducted by at least nine States, during the past three or four years—New York, Illinois, Wisconsin, Texas, Illinois, Kansas, Missouri, Louisiana and Pennsylvania. In 1912 an investigation by the Bureau of Corporations involving an estimated expenditure of from $30,000 to $300,000 was proposed. The Insurance Commissioner of Illinois in May, 1914, employed a special investigator to determine the reasonableness of rates in that State. The States of Missouri and Kentucky were for a time partially deprived of insurance, as a result of laws aimed at underwriters' associations. In view of the benefits claimed for such organizations it is surprising to find twenty-seven States having general anti-trust

[1] See p. 29.

laws which may possibly be construed (but are not usually) as applying to underwriters' associations, seven States having laws which specifically prohibit combinations to fix insurance rates, three statutes which provide for the revision of rates by the State and three which permit State boards to fix rates. Why does such hostility exist toward such apparently useful and economical bodies? Why, when railroad tariff associations, for instance, have been legally recognized, have legislators so persistently attempted to abolish combinations for the purpose of making fire insurance rates?

A prominent insurance man has said: "The two great questions confronting the stock insurance companies at the present time are (a) a revolutionizing and standardizing of its rate-making methods to place the same upon a consistent basis, and (b) a revision of its cost."[2] This is a mild statement of the views which have actuated the sincere but mistaken representatives of the people in their attacks upon underwriters' associations, stamping departments and "independent" raters. The work of such organizations as have confined themselves to forwarding the cause of fire protection and prevention has not been interfered with; in insurance "all roads lead to the rate question" and attention has been centered upon the rate-fixing and commission-regulating organizations. What are the contentions of those who oppose these organizations and which methods give rise to criticism? In order to properly understand the present attitude toward the associations we must consider the circumstances which gave rise to this attitude.

At the outset of this discussion it is necessary to eliminate one repeatedly disproven criticism, namely, that fire insurance companies on the whole have earned exorbitant profits, i. e., that the general level of rates is too high. This contention is based upon a comparison of profits with fire insurance companies' capital alone. Stock companies carry, however, a large surplus against possible conflagrations. This sum, which belongs to the stockholders, might be withdrawn and otherwise invested; if left with the insurance company it is entitled to some return. When the earnings are compared with the capital, surplus and a portion of the reserve (say 30 per cent) no basis exists for the complaint of exorbitant returns. In fact, considering the number of companies forced to retire from business, fire insurance seems a rather hazardous investment. The elimination of this possibility of generally excessive rates leaves only to be considered the important question of discrimination. There will be recognized discrimination between (a) classes of risks, (b) kinds of policies, (c) localities, and (d) particular risks. The regulation of brokers and agents also requires discussion. These varieties of discrimination will be considered in the order given.

Discrimination Between Classes of Risks.

Among the risks of insurance companies are included buildings and contents of many classes, such as hotels, dwellings, public halls and factories of all kinds, the rate, of course, varying not only according to the class, but with the character of the particular building and contents. All risks except those

[2] "Some Methods of the Fire Insurance Business," New York Journal of Commerce, March 26, 1914.

taking minimum rates are rated by schedules, which proceed from a certain basis rate and give due additions or deductions for important components of hazard. These additions and deductions are often percentages of the basis rate. The basis rate of the class is, therefore, a very important factor in the final rate upon any particular building in that class. If it is fixed higher than it should be, every building within the class suffers an injustice, and the final rate on each is higher than it should be. A basis rate too low has an opposite effect, and confers upon the class which obtains it an undeserved benefit at the expense of other classes. Under such a state of affairs the owners of some buildings are excessively taxed in order to eke out the inadequate premiums of those favored with an unjustly low rate. How is the proper basis rate for a particular class to be determined? In general the premiums on the various classes of risks should be proportionate to the losses on these classes. If for every $1,000,000 of insurance written on hotels, losses to the extent of $25,000 annually occur, and for every $1,000,000 of insurance written on apartments $20,000 is paid in losses annually, (assuming these figures for the sake of illustration), the rate on apartments should be four-fifths of the rate on hotels. Any rate above this is an overcharge of the apartment owners. It would seem that such a principle would be instantly recognized and applied by the insurance companies; but it has been claimed that such is not the case.

A report of the Superintendent of Insurance of Missouri contained an abstract of the testimony of Mr. F. J. Fetter, who promulgated fire rates for all parts of Missouri except St. Louis County, and Mr. Fetter is reported as follows:[3] "I had no figures or experiences from any of the companies showing their losses or profits on the various classifications to aid me in making up the rates. During the time that I rated the State I collected no actual data or experience of the companies showing their losses or profits. It may be, however, that under this system a man who owns a building of one kind, like a fireproof building or a sprinklered building, would be paying more than was sufficient to carry his risk; while another man owning a building specially liable to be burned would be paying less than he ought to pay, but it has been the practice to lump together the experiences from all the different schedules and base rates on these aggregate results. The rates that I made were called estimates. We had better call them estimates until they are approved, and then they become rates. They were what I considered fair, but might be termed guesses." Mr. H. M. Hess, chairman of the Missouri Actuarial Bureau, testified as follows:[4] "I have never seen any statistics covering fireproof buildings. I have no statistics to justify any of the basis schedules other than what I have quoted as to the average experiences of the State of Missouri, and they cover only the aggregate results. Many of the schedules may be too high, and others too low, but in the aggregate they produce fair and reasonable profits." Mr. J. V. Parker, whose business is the study of fire hazard and the formulation of schedules and rates, said: "No tabulated

[3] Report for 1912, pp. 9-10.

[4] Report for 1912, p. 11.

or classified statistics are filed in my office. The general loss ratio of all companies on all classes of business in each State and over all States, as shown by 'Insurance by States' and the National Board of Fire Underwriters' printed proceedings, are the available statistics showing the relation of premiums to losses on all classes of business." Mr. Parker was asked the following questions: "Did you ever see any statistics on sprinklered business? Ever see any on fireproof buildings?" and his answer was, "I have not." The fire insurance companies doing business in the State of Missouri were written to and their answers confirmed the facts set forth, almost all stating that no such statistics were kept.[5] If the lumping together of loss statistics was followed to its logical conclusion premium calculations would also be lumped together and all classes of risks would start with a common basis rate, say $1 per $100. As a matter of fact, the path of progress leads in another direction,—toward differentiation.

The question immediately arises, why is one risk rated twenty times as much as another? Why is the basis rate on grain elevators $1.50 and on iron foundries $1, machine shop schedule $1.25, tin can factory $1.59, flour mill schedule $1.75? Equal basis rates are not demanded, for that would be even more unjust than present arrangements; but the theory is that a fire rate equitably measures the fire hazard, and if there is no record of experience to show that there is a greater risk assumed under a sawmill schedule with a basis rate of $2.50 than under a school schedule with a basis rate of 50 cents, how can it be determined that these rates are fair and reasonable? In other words, has not the questioner as much proof of the inequity of the several rates as the defender has of their correctness, that is to say, none at all? How could those promulgating rates justify them to the public? In other words, the critics claimed that the associations' rates were not based on classified statistics.

It was stated with reference to one association that "there are no figures officially gathered which will accurately reflect the ratio of losses to premiums in exchange territory. Practically all rating is done independently of other rating organizations upon bases and schedules peculiar to the exchange, and it should be considered as a matter of importance to ascertain the premium rate, the premium volume and the loss ratio, in order to test the results of its rating methods. It, therefore, seems almost incredible that no systematic effort was ever made by any one in authority to ascertain these figures." This was claimed to be true both as regards classes of risks and aggregate business.[6] The attempts to gather statistics for rate-making were alleged to be few and far between, and on a number of occasions important rate changes were based upon incomplete and unsatisfactory data. In a statement by the New York Superintendent of Insurance the following appeared:[7] "It is a noteworthy fact that, with the exception of rates on very few classes, the rating associa-

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[5] Annual Report of the Superintendent of Insurance of Missouri, for 1912, p. 14.

[6] Report on Examination of New York Fire Insurance Exchange, July 21, 1913. New York Insurance Department, pp. 10, 95, 125. (Hereafter referred to as "Report.")

[7] THE MARKET WORLD AND CHRONICLE, 1913, p. 91. See also Report, pp. 95, 99, 106 and 107.

tions are obliged to grope their way without the aid of the statistical experience of the companies for whom the rates are made. It is in evidence that the associations on various occasions requested their members to furnish figures on certain classes, and when the association succeeded in obtaining a fair volume of figures it was considered worthy of comment. With the exception of competitive rates, changes in rates have been made in the past for two reasons: First, because one or more companies discovered that a certain class proved unprofitable, the result generally being an advance in that class; second, because a distinct class of insurers would band themselves together, collect from sources available to them statistics regarding the premiums and losses in that class and then threaten to form or insure in mutuals unless the rates in the class in question were lowered; and, generally, such action was followed by a reduction in rates."[8]

To appreciate the situation which is here complained of one must know the origin and purpose of the classification of figures kept by the various companies. They were prepared for the purpose of competition, in order to measure the profitableness of writing various classes of risks. Such lists were maintained at heavy expense, for each policy written had to be carefully examined to determine the class of risk. A. F. Dean cites an instance of a risk of $5,000, wrongly classified, which affected the loss ratio of one class 25 per cent and of the other class nearly 100 per cent, which illustrates the necessary degree of care.[9] They were and are guarded as secrets by each company—regarded as a kind of stock in trade. In earlier days, when one company not only could but was forced to make its own rates because of lack of co-operation, these classifications served in a crude way as a scale by which to measure rates. At the present time, when companies are compelled to carry all classes of risks, desirable and undesirable; when companies co-operate, to some extent at least, to make rates; when competition is keen and the margin of profit small as compared with earlier periods; the usefulness of these classifications in their present form has ended. The following table,[10] covering a number of companies for a five-year period and showing the best and poorest loss ratio (from the standpoint of the company), is sufficient to give an idea of their unreliability:

Class No.	Showing of Any One Company as Regards Lowest Loss Ratio.	Highest Loss Ratio.
1	.00	1.11
2	.10	2.13
3	.00	1.31
4	.06	1.28
5	.18	1.69
6	.03	.92

In discussing this phase of the public's criticism we may dismiss at the

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[8] For an example of successful results of such a procedure see the report of the Fire Insurance Committee, National Convention of Building Managers, reported in "Building Management," August, 1911, said Committee having prepared an interesting comparison of about 160 office buildings.

[9] A. F. Dean, "Fire Rating as a Science."

[10] A. F. Dean, "Fire Rating as a Science," p. 74.

outset all question of the possibility or desirability of classified statistics as a basis for rates; this is an open question among underwriters.[11]

There can be no doubt, however, that such statistics would do much to satisfy the public that the rating system rested on a tangible base. The lack of them is nevertheless not traceable to underwriters' associations, but rather exists in spite of the efforts of these bodies. Evidently the spirit of co-operation among the companies is not strong enough to induce them to surrender certain figures which, in their hands, are weapons of competition, but in the possession of the associations would be a defense against discrimination. It is of record that various associations have often used every effort to secure statistics which would better enable them to make rates in particular localities. Their failure is but an instance where co-operation has failed to abolish privately-kept statistics which are relics of former competition.

Furthermore, regardless of the extent of accuracy of a schedule itself, considerable opportunity for its imperfect application was claimed to exist. In a former section[12] some of the more important schedules used by a large association were described. A great variety of rules are applied in the work of using these schedules, which are of extreme importance to the insured and should be available for reference by all members of the association. In some cases, however, no properly codified sets of rules were possessed and since no one rater was familiar with all the rules the natural consequence was that uniformity in their application was impossible. No attempts have been made, however, by the associations to keep these rules secret. On the contrary, of late years they were, in many cases, published in the bulletins issued by the exchanges. The early rules which still remained in force, nevertheless, were unknown to brokers. Knowledge of a large number of the rules became the possession of a few brokers, through long experience or otherwise, and

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[11] Some authors, including underwriters, admit the value of classified data, whereas many others deny that its collection is possible and some its usefulness if it could be collected. For the first view see

David Rumsey, "A Suggestion for a Method for the Control of Fire Insurance Rates," THE MARKET WORLD AND CHRONICLE, December 6, 1913, p. 722.

Report of the New York Legislative Investigating Committee, 1911, p. 68.

Report of Special Committee on Uniform Classification of Fire Insurance Experience, National Association of Insurance Commissioners, 1913.

Report of the Insurance Commissioner of New York, 1913. See also THE MARKET WORLD AND CHRONICLE, February 28, 1914, p. 292.

E. G. Richards, "Classification—Discrimination," address before Insurance Society of New York, 1913.

E. G. Richards, "Why I Believe in Classified Experience," address before Insurance Library Association of Boston, 1916.

E. G. Richards, "Experience Grading and Rating Schedule," 1916.

For the latter viewpoints see A. F. Dean, "Classification" and "Classified Experience." For an example of an attempt at classification see the Reports of the Texas State Rating Board and E. G. Richards, "Experience Grading and Rating Schedule," 1916. See also the author's "Co-operation and Classification in Fire Insurance." Quarterly Journal of Economics, August, 1916.

[12] See "Local Underwriters' Associations," p. 15.

this gave them an advantage over less fortunate competitors, and the clients of the former benefits not possessed by those of the latter. Charges for exposure were formerly assessed by a "judgment" system, but of late years there has been considerable extension of the use of "exposure tables." Rules are necessary to govern the application of the tables to the different classes of risks and in addition to these numerous special rules and office practices obtained in many associations which materially modified and even completely waived the application of the exposure charge. In the case of one of the most efficient of local associations it required several months to produce a fairly complete enumeration of these rules and practices.

Often such rating rules are rather old. Some were obtained by existing associations as an inheritance from their predecessors, others they have themselves adopted from time to time. In the formulation of such rules, and particularly the older ones, consistency has not always been the principal consideration. As a result, when a risk on the border line between two schedules was rated by one, a rate was produced wholly inconsistent with the rate which would have been obtained by the application of the other. The transfer of a mercantile risk with many occupants to the manufacturing schedule because of a slight change in occupancy has been cited as an example.

Schedule rating, the advantages of which were enumerated in a previous section,[13] while producing reasonable justice as between risks of the same class, does not necessarily eliminate unfair discrimination between different classes of risks. One large association may employ in its rating activities as many as twenty schedules, and many of the schedules are not designed primarily to harmonize with each other. There is also opportunity for class favoritism in the preparation of schedules. Despite its title the Universal Mercantile Schedule is not universally applied in its original form, and its use in modified form is generally confined to the larger cities in New England and the Middle States. Even in such places it applies only to certain classes of risks, and numerous other schedules upon different plans are employed for other classes. Furthermore, similar hazards may be differently charged for by different schedules. This is referred to in a later section under the heading "Discriminations Between Localities" (p. 48).

The above two criticisms, namely, the failure to collect statistics to support rates and neglect of providing a codified set of rating rules which would be harmonious, were fairly directed against the associations. As regards the first of these, laws should have been enacted penalizing companies for failure to furnish data upon which to base rates. The enactment of statutes would have relieved the companies of the fear that they alone were furnishing data, while others refrained from doing so and made unfair use of such of their competitors' figures as they could obtain. Under such laws the associations could have enforced compliance with their requests. At the present time the alternative seems to be, furnish the data to the associations or furnish it to the State under a State rating system. In the light of their past experience

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[13] "A Survey and Classification of Fire Underwriters' Associations in the United States," p. 3.

with State rating systems, there is little doubt as to the companies' choice. These criticisms, however, and many that follow, are only indications of the imperfections and abuses of the rate-making system. They do not in any way affect the contention that underwriters' associations are the most economical means of performing the work yet discovered, and that they perform certain other economic functions which were described in preceding articles.

In the territory covered by a large urban exchange the risks rated by schedule form but a part of the total. There still remains to be considered that large class which takes minimum rates, i. e., dwellings, churches, schools, etc., or "preferred risks." In large measure, what has been previously said applies also to these risks, for it was claimed that they, too, were granted a rate which lacked the support of loss statistics. This class was but one of the many lumped together in the aggregate figures. Mr. Hess in his testimony stated: "The Dean Schedule does not cover dwellings. On the aggregate loss theory it is not possible to state how much the companies make or lose on dwellings. It is possible under this theory for the rates on some classifications to be too low and others too high. We have no way of telling what the losses are on each classification."[14] Minimum rated risks and schedule rated risks, therefore, subject themselves to criticism for the same reason. How can it be shown that the minimum rates granted are just and reasonable in the absence of classified loss statistics? Mr. Hess stated that it is possible that the rates on some classes might have been too high. Since nine-tenths of the dwellings are owned or rented by persons of moderate means, without influence, is not this the class likely to be charged exorbitantly? Because of the lesser hazard which must necessarily be present in this class as compared with some others, and the consequent *actual* but not *relative* lowness of the rate it is easier to collect a little additional from this class than from others more hazardous. It might be presumed that the property owner would have protested if he thought the rate was high. The companies would show him that every one who owned a dwelling was paying that rate, and the difficulty he would have of forming a combination of dwelling owners can be imagined. Secondly, a protest against factory rates is a business matter, but the questioning of a dwelling rate means time and trouble outside of business hours. Thirdly, as was stated by the Insurance Commissioner of New York, the way to obtain a reduction is to band together and collect from available sources statistics of premiums and losses; and this is plainly almost impossible in this class.

However, it is unnecessary to point out the reasons why such discrimination was present since there is evidence that it has existed. The term "preferred" is rightly applied to these risks, because underwriters do prefer them; unless they yielded a larger profit what reason for such preference would exist? Mr. James A. Waterworth, a Missouri rate expert, said, "Dwellings and minor business houses, frequently stores below and dwellings above, and generally the small stores throughout the city, are known as preferred risks

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[14] Annual Report, Superintendent of Insurance of Missouri, 1912, p. 12.
[15] Report of Superintendent of Insurance of Missouri, 1912, p. 13.

because they are considered more profitable to the companies."[15] If the name applied to these risks and the testimony of raters were not sufficient evidence, the actions of the companies would be. Competition for this particular business is very keen. All companies insist upon brokers giving them their due proportion of this class of business and are always willing to accept more than their share. Larger commissions are paid for securing these risks and many companies will not accept more hazardous risks from agents and brokers unless judiciously "mixed" with "preferred" business. It has, therefore, been the practice of brokers to deliver "lines" of insurance in bulk, using the preferred risks to offset the poorer risks, and their profit partly depends upon their ability to skilfully mix risks.

This question of dwelling rates has been discussed in the more progressive journals. The Chicago correspondent of THE ECONOMIC WORLD wrote:[16] "The rates on dwellings in Illinois outside of Cook County are much like those in other Western States, and they are high enough so that most of the companies appear anxious for the business at the rate. But inside the County, in towns with paved streets, waterworks, paid fire departments, electric alarms and telephones in nearly every house, rates are far and away higher than in villages outside with almost primitive protection. * * * These rates cannot be defended." The editor of this journal, in the same issue, states: "Now, this state of things is not confined to Cook County, Illinois. It is to be found, in a greater or less degree of unfairness, inequitableness and departure from consistent uniformity, in all parts of the country where the pressure of competition has taken the form of striving for the largest possible share of an over-profitable business, rather than meeting the demands of able bargainers among buyers of insurance."

It is not an answer to policyholders, it is contended, to allege that higher rates exist because of higher commissions to agents. The matter of commissions is to be settled between companies and agents; the policyholder has no voice in fixing the amount to be paid agents and, therefore, cannot be compelled to suffer because it is high. The owners of dwellings seem to be in the peculiar position of paying more premiums, by reason of the high commissions, in order that the companies may extract from them more profit. They offer a little more inducement to come and get their business, because it is profitable, than the same agents could obtain for writing a more hazardous factory, warehouse, or mercantile building.[17] In New Zealand, where State fire insurance has been in force for eight years, the greatest reduction in rates claimed has been on dwellings—33⅓ per cent.

The factors considered in the rating of a risk may be divided into three

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[16] THE MARKET WORLD AND CHRONICLE, January 13, 1912, p. 35.

[17] See letter of one manager to New York Fire Insurance Exchange with reference to an increase in rates on household furniture in brick dwellings, in which he says: "Not only is its exceeding sweetness drawing many 'flies' that are increasing the competition both fair and unfair, but the companies have no right to advance rates on property that they are willing to pay an agents' commission on of 35% in addition to other expense direct or indirect of not less than 10 or 15%." Report, p. 102.

groups, construction, occupancy and exposure. Complaints have been made of the rules and methods adopted by exchanges for the measurement of exposure. It has been stated that "the rules and their application have moreover resulted in injustice and absurd inconsistencies, which discredit the judgment of the underwriters responsible for such conditions." Failure to modify exposure tables to conform to improvements in protection and the existence of little known exposure rules are claimed to have resulted in great variation in the exposure charge as applied to risks rated by different schedules, and, in fact, as applied to risks rated on the same schedules, but belonging to different classes, as well as in the relationship of the exposure charge as applied to stock or contents when compared with the exposure charge applied to buildings. With regard to one city it has been stated that "The exposure table has remained practically unchanged during the thirteen years of the existence of the exchange. The use of the table during that period has been steadily extended, until it now covers almost all classes of risks, and its application, where used, has in recent years become more rigid. As a result, the exposure charge now constitutes a more important element of the rates fixed by the exchange than at any other period of its existence. And this, notwithstanding that the exposure hazard has been materially lessened by the installation of the high pressure system, and an increased efficiency of the fire-fighting force. * * * The high-grade public protection against fire has a tendency to equalize the exposure hazard from risks of varying character, although underwriters fail to recognize it in the rating."

Injustice also results, it is alleged, from unfair discriminations between classes in the exposure charge, resulting from difference in the basis rates or the application of different schedules. For example, a sculptor's studio furnished a basis for a greater exposure charge than a newspaper printing plant. Risks exhibiting dangerous conditions suffer an increase in rates therefrom, which results in increased rates on neighboring risks through the exposure charge. Nevertheless, associations have refused to divulge the reasons for the advanced rates to interested and affected neighbors and have not assumed it to be part of their duties to co-operate with the fire prevention authorities to have the improper conditions remedied.

One of the objects for which insurance associations exist is the improvement of construction and the reduction of fire waste. Fire rates are the greatest factor in effecting good construction and improving poor, because of the direct pecuniary interest involved. Fire insurance companies have promised property owners for some time that if proper precautions were taken and losses reduced, premiums would be lowered. Of the devices for reducing fire damage the automatic sprinkler is one of the most important. When the fire becomes hot enough to melt solder on a sprinkler head the place is flooded with water. This is a device which has proved very effective and many owners of mercantile and factory buildings have installed it. Under the present method of aggregate loss statistics, how do these owners know they have been granted the proper reductions? Some of the rates, upon risks equipped with automatic sprinklers, it is certain, have been made without the assistance of any guiding statistics or any knowledge of what aggregate profit is made on

this class of business. In one large city the rates upon sprinkler risks were not reduced until competition by factory mutuals forced this action, and then those risks already insured with mutual companies and those threatened with competition were first considered. The restricted sprinkler schedule here was concededly devised to meet competition, and apparently the changes in it and the rules applying to it have generally been made owing to mutual competition.

The preceding attempts to give some idea of the conditions which were believed by the public and the legislators to exist in fire insurance, as regards discrimination between classes of risks.[18] In addition different kinds of policies, localities and particular risks suffered it was believed because of abuses of the system of rate-making. Because of the suspicion with which business combinations of all kinds were regarded, every instance of this kind was exaggerated and every particular instance considered a general condition. No effort was made to ascertain whether the associations possessed advantages which offset the disadvantages,[19] and an antipathy was consequently engendered which demanded the abolition of all forms of co-operation.

Thus far [1] a cause of the public enmity toward underwriters' associations was sought in the discrimination which was believed to exist between classes of risks. Other causes of anti-compact, State rating and regulative laws were discriminations between kinds of policies, between different localities and particular risks. While some contended that rates in general were too high, it was generally admitted that any real cause for criticism must be found in the pernicious practice of favoring some risks as compared with others.

Discriminations Between Kinds of Policies.

Fire insurance policies may be divided into three classes, according to their duration. Annual policies are customary. There also exist, however, "term" policies having durations of three and five years and "short term" policies or insurance for less than one year. The object of insuring for three or five years in preference to one year is to obtain a so-called "term" rate, which is lower, proportionately, than the annual rate on the same property. The rate for a term of three years is usually only double the annual rate and for a term of five years only triple the annual rate. The justification for these rates has long been a mystery to the public, largely because they could not be reconciled with certain contentions of the underwriters. If the annual rate is proper, fair and only adequate to cover losses, expenses, contingencies and a five per cent profit, as has been claimed, how can insurance for five years be granted at a lower rate? On the other hand, if the five and three year or "term" rates are sufficient to cover these various items, why should a higher rate be charged for one-year policies?

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[18] All of the criticisms contained in this section, it is to be understood, are not endorsed by the author.

[19] The very important economic function of the associations have been described.

[1] Page 36.

There are, of course, some elements which are not currently taken into account, two of these being:

(1) The interest which is earned on the larger amount paid in as a premium at the beginning of the term, on the term basis, and

(2) The saving in expense due to writing five years' insurance, say, at one time.

Suppose we have a risk bearing an annual rate of $1.15 which is granted a term rate of $3.45 for five years' insurance. The apparent difference between the two rates is $2.30, which, however, is partly accounted for by the two elements just named. Let us assume that the term premium is received at the beginning of the term and the annual premium on the first of each of the five years. We may assume that the company will earn interest on the amounts held, considering the nature of the funds; that losses, on the average are paid in the middle of the year and consume 55 per cent of premiums; that expenses amount to 35 per cent; conflagration fund, 5 per cent; and profit, 5 per cent.[2] If figures were available showing the interest which might be earned by the company on funds on hand it would be possible to compute the saving in the form of interest which results from the collection of a term premium. For example, out of an annual premium of $1.15 paid in at the beginning of the first year of the term must be taken 35 per cent for expenses, leaving 74.75 cents. For half a year this sum earns interest and in the middle of the year losses of 63.25 cents (55 per cent of $1.15) must be paid, leaving a small remainder to accumulate at interest for the remaining half year. At the beginning of the second year a second premium of $1.15 is paid and the process repeated. If, however, a term premium of $3.45 is collected at the beginning of the first year and expenses of 40 cents are deducted, the sum of $3.05 remains to earn interest for one-half year. At the end of this time 63 cents is paid out for losses, leaving $2.41 to accumulate at interest for one-half year. It can be seen that there is a considerable gain in interest and saving in expense on the term plan from the standpoint of the company.

There are, however, two other elements which have not been considered:

(1) The advantage of keeping the business, and

(2) Of having on hand the premium, whether earned or not, in case of loss.

These are advantages to the insurer difficult to estimate, and it is a matter of opinion whether they would be of sufficient advantage to compensate for the 44 cents difference in premium receipts. It must be acknowledged, however, that a high estimate has been made of the saving in expense. On the other hand, the risks which are granted term rates are usually of a less hazardous nature and losses on them would probably be less than the average of 55 per cent of premiums, while losses on others would probably be greater than the average. In general, the conclusion may be drawn that the difference complained of between annual and term rates has usually been exaggerated.

Term rates are not granted to all classes of risks, and with respect to the favored ones practices vary with different sections of the country. Some risks

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[2] Report on Insurance to Senate and Assembly of New York, February 1, 1911.

cannot be insured for more than one year; others may be, but must pay the full annual premium without reduction for the longer term; others may be insured for long terms by increasing the premium by one-half for each year over one, and still others by increasing the premium by three-fourths for each year after the first. Furthermore, the risks are not placed in these groups because of peculiar characteristics or established classifications, but are shifted from time to time "without any definite guiding principle or standard."[3] The reasons which are said to justify term rates are (1) that they tie up the business longer, (2) that a larger amount of interest is earned, (3) that the expense is reduced, and (4) that they provide a premium, whether earned or not, available if loss occurs. As far as buildings are concerned, why should there be a distinction in the ratio of term rates to annual rates, considering these factors? Which of these reasons applies to one class of buildings and not to another? So far as can be seen, none of them affords any basis for discrimination between classes. The most important objection, therefore, to term rates is the arbitrary manner of allowing them on some risks and not on others. A. F. Dean says, "If this (a standard scale for long term rates) were adopted as a standard, and as universally observed as our present short rate standard, it would have two excellent results. First, it would stop the growing confusion in our tabulated annual statistics, caused by the ominous growth of term risks. Second, it would prevent discrimination in favor of the man with ready cash who cannot put it to more profitable use than to save a year's premium on his three-year policies. * * * "[4]

As regards short term risks, the situation is considerably better. Several such tables have been promulgated, including that of the Western Union, and these tables are usually applied to risks regardless of class.

What has been said above regarding long and short term risks serves to illustrate the conditions which exist in business where co-operation is absent or restricted. If, even with the assistance of associations and boards, non-uniformity exists, the situation under unrestricted and unprincipled competition may well be imagined. It is probable, for instance, that instead of the Western Union table for short rates being generally applicable throughout the Middle West, every company would establish any standard of measurement it thought proper or advisable, and the extent of discrimination would be only limited by the ability of the powerful to force concessions from the companies.

Discrimination Between Localities.

A third type of discrimination is that which differentiates between localities; and an evil which was apparent even to underwriters was the failure to harmonize and relate the rates of different parts of the country. Co-operation has to a large extent established a relation between the rates on all the risks within the territory of individual exchanges, but co-operation had not then and has not yet reached the stage where any definite relation can be shown to

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[3] A. F. Dean, "Standardization," Proceedings, 42d Annual Meeting, Fire Underwriters' Association of the Northwest.

[4] A. F. Dean, "Standardization," Proceedings, 42d Annual Meeting, Fire Underwriters' Association of the Northwest.

exist between the rates on particular classes of risks in New York and in San Francisco, for example. Commenting upon the system of rating in 1901, A. F. Dean said, "We construct a basis schedule of each State, but cannot show that it bears any logical relation to the schedules of other States. We say that each individual rate is the sum of a basis rate combined with certain charges and credits, but cannot show whether this basis rate is relatively correct when compared with others, nor can we show that the charges and credits which permeate many classes are consistently imposed upon each class. This naive disregard of relations crops out not only in the comparison of every existing basis tariff with other tariffs, but in the comparison of parts of the same tariff with other parts."[5] Selecting ten tariffs Mr. Dean compared their charges for specific defects, and rearranging his table, it shows the following:[6]

	Number of Times Some Charge Appears in all Tariffs.	Am'ts of Different Charges Made for Same Defect.
Awnings, wood, on one-story building.....	4	5 cents
	4	10
	1	20
Lighting by other than gas or electricity	2	5
	27	10
	5	15
	26	25
Metal stack through roof (metal roof)	3	5
	1	15
	9	25
	3	50

These are three examples picked from a list of thirty-two at random, which serve to show the inconsistencies in charges. It is doubtful if the same extent of inconsistency can be found to-day, for rating methods steadily improve, but similar differences can be found, even if not of the same extent. Quoting again from the same authority:[7] "It would be a truism to say that in the face of inconsistencies so glaring, explanation or defense is impossible. The public contention that rates are made 'by guess and begad' is susceptible of proof from the documentary evidence contained in our own tariffs. It matters not that * * receipts and disbursements come out exactly even, if taken for decade periods; in other words, that indemnity as a whole is practically sold at average cost.' Our failure to make a profit does not concern the public, but our failure to maintain reasonably true rate relations offends the sense of relation which is instinctively the basis of every reasoning process. Even low rates that are inequitable are an offense to common intelligence."

Within the last year or so the relation of the rates on urban dwellings to those on suburban risks has been the subject of contention. There is quite a difference between a farm building, subject to burning for an hour, perhaps, through the failure of untrained volunteer firemen to respond or by their lack of knowledge and efficient apparatus, and a city dwelling, surrounded by hun-

[5] A. F. Dean: "Fire Rating as a Science," p. 53 et seq.
[6] Ibid., p. 53.
[7] A. F. Dean: "Fire Rating as a Science," p. 54.

dreds of volunteer firemen and within ten minutes' journey of an improved chemical engine. Yet in some States practically no allowance was made for the difference in hazard due to municipal water supply and fire departments. Thus at one time, for example, the rate on frame dwellings in the State of Illinois was 40 cents, with no charge added for exposure, while dwellings in Chicago, with water supply and fire department, paid 50 cents and a charge for exposure in addition.[8] Even the Illinois Commission, assisted in its investigation by a prominent underwriter, which rendered the most favorable State report on conditions in the fire insurance business prior to the New York report, was compelled to say, "It is very hard to escape the conclusion that owners of dwellings in Chicago are grossly overcharged."[9]

Discrimination Between Particular Risks.

More unfair, however, than discrimination between classes of risks, kinds of policies and localities, are discriminations between individual risks. This type of favoritism has been considerably diminished of recent years, but still exists to some extent. An agent represents sometimes as many as twenty different companies. In order to place large risks without dividing his commissions with other agents this is a necessity, for the companies restrict the amount they will write on any one risk in order to obtain good distribution. The agent has a lot of smaller risks which all the companies desire and urge him to supply them with, even maintaining special agents to see that they receive their share of such "preferred" risks. He also has some risks which no company wants *at the price offered*. The agent, under the compulsion of the owners of the large but poor risks, takes advantage of this situation and shrewdly mixes the good with the poor, offering the lot in bulk to the various companies. All or none must be taken, and by careful mixing and the competition of the companies, the agent usually succeeds in placing his risks. The existence of the preferred risks, which he wants, thus compels the manager of a company to accept other risks at inadequate premiums. The large risks are able to command such advantages solely because of their size, the large commissions obtained by the writing and the competition of the companies.

The manner in which companies may compete in rates is shown by an illustration by L. W. Zartman.[10] "Let us assume that a risk, say a factory, is offered to the company; the company wants the business, but competition is keen and a competitive rate must be named. To find out this competitive rate it is only necessary to analyze the expenditure of the company. The total premium income, in general, is paid out as follows:

Losses	55 per cent
Commissions	15 per cent
Salaries of special agents	5 per cent
Home office expenses	15 per cent
Taxes	3 per cent
Profit	7 per cent

[8] Report of the Illinois Fire Insurance Commission, to the 47th General Assembly, p. 57.

[9] Ibid., p. 57.

[10] L. W. Zartman: "Yale Readings in Insurance," New Haven.

"If the burning ratio on the class to which the factory in question belongs is $0.825 per hundred, in order to get the current rate of profit, to charge the factory its proportion of the fixed expenses and to pay the agent the regular commission, the company would have to name a rate of $1.50 per hundred on the factory. It will not charge that rate if a lower rate is necessary to secure the business from a rival, and it need not in order to make acceptance of the business profitable, as the expenses for special and home office force will continue whether that risk is accepted or not, and both of these can be ignored in making the rate. The tax will have to be paid, and some commission to the local agent, though at times the agent is willing to take a smaller commission in order to induce the company to accept the risk. Therefore, a company can fix a rate of $1.00 on the risk and still make a profit as follows:

Expected loss	$0.825
Taxes	.03
Commission	.10

which make a total expense of $0.955, leaving a profit of nearly 5 per cent to the company upon the transaction, even with the heavy reduction in rate." It is unnecessary to point out that some other risks bear this factory's proportion of the expense, which it did not pay.

The above illustrates exactly the situation which would prevail universally, and has prevailed universally, without the existence of some means of restricting competition, such as underwriters' associations. When such associations were mentioned by the writer to an officer of a very large corporation the latter said: "Oh, they aren't of great account. When we talk to a broker about placing our business we always tell him that if he has in mind an underwriters' association rating he is just wasting his time. We won't have anything to do with them." This is the most potent argument that could be advanced in justification of such co-operation. This large corporation, through the value of its large insurance business, induces companies to compete, obtains a lower rate than its competitors can hope for, and thus compels underwriters to disregard the agency which they have established to promulgate uniform rates.

A study of these associations shows that from them result in fire insurance the many direct and indirect advantages which follow co-operation in any business pursuit, and in addition the technical character of this particular business renders their existence especially valuable, both to the companies and the public. As with every other economic agency, however, the same power which in general renders public service may be utilized in some instances and to some extent for private gain and to the general detriment. Thus the Interstate Commerce Commission unofficially recognizes now that railroad traffic associations are absolutely necessary in present-day land transportation; Congressional committees realize that agreements between steamship lines are the only solution of certain water transportation difficulties; and yet it is also seen that certain abuses of the existing system are liable to become prevalent. So in fire insurance co-operation was a certain misuse of power introduced, insignificant in comparison with the general improvement of present methods over old, but which legislators desired to eliminate.

These evils in the midst of good may be briefly outlined as follows:

1. Discrimination between classes of risks:
    - A. Inability to justify basis rates by classified statistics;
        - (1) Failure of associations in collecting statistics;
        - (2) Incompleteness of the figures in existence.
    - B. Diversity and imperfect compilation of rules for rating.
    - C. Lack of harmony between class schedules.
    - D. Overcharge on "preferred" risks.
    - E. Absence of relation between exposure charges.
2. Discrimination between kinds of policies:
    - A. Term rates.
3. Discrimination between localities:
    - A. Lack of harmony between schedules of various localities.
    - B. Inconsistencies of urban and suburban rates.
4. Discrimination between particular risks:
    - A. "Mixing" risks.
    - B. Making reductions for large lines.

Many difficulties in the treatment by legislators of this common phenomenon were created by the mistake of applying old legal principles indiscriminately to new conditions. Thus the mere fact that fire insurance companies combined in rate-making and that such combination did not immediately perfect conditions caused them to be placed in the category of evil trusts, and their interconnection to be abolished at all costs. This section was intended to show the origin of such an attitude; the development of resulting legal restriction from the prohibitory basis to the regulatory principle remains to be discussed.

THE LEGAL STATUS OF FIRE UNDERWRITERS ASSOCIATION

IT is almost unnecessary to point out that the power of the several States to regulate the business of insurance within their respective borders is derived from the decisions of the United States Supreme Court in Paul vs. Virginia (1868)[1] and New York Life Insurance Company vs. Deer Lodge County, Montana (1914).[2] In the first of these the court enumerated the principle that contracts of insurance "do not constitute a part of the commerce between the States" but are "local transactions" and "governed by the local law"; in the second case the court reaffirmed this principle. Improper conditions are, therefore, not remediable by the application of any of the Federal statutes relating to interstate commerce, but the regulation of this business consists entirely of the diverse and ever-changing laws of the various

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[1] 8 Wall. 168.

[2] United States Supreme Court, Spring Term, 1914.
The Supreme Court of the District of Columbia dismissed a bill for injunction to restrain the Home Life Ins. Co. of New York from continuing as a member of the Underwriters' Association of the district. It held that the Sherman Act did not apply to insurance.

States. The activities of fire insurance associations may be restricted in any of four ways:

(1) By virtue of the common law, in the absence of statutes specifically limiting the manner of doing business.

(2) Under "anti-trust" laws, either in the form of

(A) General anti-trust laws, of the nature of the well-known Federal "Sherman Act," governing all kinds of business, or

(B) Statutes governing insurance companies only or specially mentioning these as included within their scope.

(3) By means of State rating laws which are either

(A) Laws providing that the State shall prescribe maximum or actual rates, or

(B) Laws which require that all rates must be approved by some State authority.

(4) By acts providing for the supervision of rate-making in certain particulars by State officials having power to prevent abuses.

The Common Law.

It is probable that insurance companies might have escaped molestation for many years had it not been for the inauguration of the once-popular antipathy to combinations of all kinds. In this insurance associations could not fail to be included and a multiplication of suits under the common law was the result.

The common law doctrine with respect to restrain of trade has been briefly stated as follows: "Contracts that were in unreasonable restraint of trade at common law were not unlawful in the sense of being criminal, or giving rise to a civil action for damages in favor of one prejudicially affected thereby, but were simply void, and were not enforced by the courts."[3] "Where the sole object of both parties in making the contract as expressed therein is merely to restrain competition, and enhance or maintain prices, it would seem that there was nothing to justify or excuse the restraint, that it would have a tendency to monopoly, and therefore would be void."[4]

The courts have uniformly refused to consider associations of fire underwriters, having for their purpose the fixing and maintenance of rates, as illegal or void per se.[5] Even where the term "unlawful" has been applied by the courts to associations of this nature, as in Beechley vs. Mulville, it has probably been used in the sense of extra-legal, rather than as meaning that it furnished a ground for criminal or civil action. In several cases this attitude has been maintained even though the court seemingly admitted that it considered the particular defendant's actions as a restraint of trade. Thus it was

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[3] United States vs. Addystone Pipe & Steel Co., 85 Fed. 271.

[4] Roller Co. vs. Cushman, 143 Mass. 353; Gloucester Isinglass & Glue Co. vs. Russia Cement Co., 154 Mass. 92; Continental Ins. Co. vs. Board of Fire Underwriters of Pacific, 67 Fed. 310.

[5] Harris vs. Commonwealth, 73 S. E. 561 (1912); Beechley vs. Mulville, 102 Iowa 602; Metzger vs. Cleveland, 13 Ins. L. J. 855; Queen Ins. Co. vs. Texas, 86 Tex. 250; Continental Ins. Co. vs. Fire Underwriters of Pacific, 67 Fed. 310; Aetna Ins. Co. vs. Commonwealth, 106 Ky. 864.

said: "The most that can be said as to the combination to fix, regulate and control the business of fire insurance in the city of Newport News is that it was an agreement in restraint of trade. But agreements merely in restraint of trade are not illegal in the sense that they are either indictable or actionable."[6] Contracts to maintain rates are, however, extra-legal and unenforceable.[7] In Harris vs. Commonwealth, the court quoted Mogul S. S. Co. vs. McGregor, as follows: "Contracts as they are called, in restraint of trade, are not, in my opinion, illegal in any sense, except that the law will not enforce them. It does not prohibit the making of such contracts. It merely declines, after they have been made, to recognize their validity. The law considers the disadvantage so imposed upon the contract a sufficient shelter to the public" (p. 563). Parties thereto cannot resort to the courts for enforcement or for redress against an associate. In Beechley vs. Mulville it was said: "Of this combination plaintiff was a member. The penalties imposed, among which is that of 'removal of all companies from the offending member,' are specified in the compact, and his name is signed thereto. He is himself one of the conspirators who devised and put in operation that which caused his injury. * * * It can be said, undoubtedly, that plaintiff has caused the injury of which he complains by his unlawful acts."[8]

Such associations may be, and have been, attacked, however, on grounds of public policy. Under such circumstances it must be shown that the restraint exercised is unreasonable and affects the public interest, or is employed with respect to an article of necessity.[9] "In cases like this the decisive question then is: Is the rule a reasonable trade regulation, or an unlawful restriction upon the right of the individual to employ in the conduct of his business such legitimate means as are needed to successfully carry it on? If it is not a reasonable business regulation, it should not be upheld. * * * "[10] The view is well supported that insurance is affected with a public interest and is at least of a quasi-public nature.[11] "The conclusion that we reach from these considerations is that the business of the defendants is in point of fact one that directly affects the interests of the public * * * and * * * in point of law * * * is affected with a public interest."[12] The New Jersey Chancery Court stated that insurance companies are not public or quasi-public bodies,[13] in an opinion which was overruled. Insurance is, furthermore, not a necessity of life and not indispensable.[14]

Successful actions at common law against underwriters' associations have

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[6] Harris vs. Commonwealth, 73 S. E., p. 563.

[7] Harris vs. Commonwealth, 73 S. E. 561; Beechley vs. Mulville, 102 Iowa 602; Metzger vs. Cleveland, 13 Ins. L. J. 855.

[8] 102 Iowa, 610.

[9] Louisville Board of Fire Underwriters vs. Johnson, 119 S. W. 153 (1909).

[10] Louisville Board of Fire Underwriters vs. Johnson, 119 S. W. 157 (1909).

[11] McCarter vs. Firemen's Fund Ins. Co., 73 Atl. 80 (1909); Citizens Ins. Co. vs. Clay, et al., 197 Fed. 435 (1912); Queens Ins. Co. vs. State, 102 S. W. 1048 (reversed on appeal).

[12] McCarter vs. Firemen's Fund Ins. Co., 73 Atl. 85 (1909).

[13] McCarter vs. Firemen's Fund Ins. Co., et al., 61 Atl. 705 (1905).

[14] Harris vs. Commonwealth, 73 S. E. 561 (1912).

been few in number, but several of the associations' acts have been declared to be illegal. Thus, where efforts were made to regulate rates, commissions and the intercourse of members and, it was alleged, to boycott certain companies, if such efforts could have been plainly shown to have been the actions of the association, the decision would have had to be against it.[15] Provisions prohibiting members from writing insurance for non-members; from having more than two agents with offices in the congested portion of a city; from disclosing the manner of making rates to anyone except a member of the board expressly designated by the owner of the risk; provisions requiring the cancelation of risks written at other than the board rates; and the practices of adding charges for faults of management, etc., without giving notice that such charges were removable if the faults were remedied; and of notifying members of the final rate without giving details, are contrary to public policy, illegal and void.[16] Other decisions have held the delegation of rate-making powers to an association to be ultra vires an insurance company[16x] and a by-law stating that "no member of this board shall take the agency of a company which has already an existing agency in a city" to be reasonable and not illegal.

Statutes Prohibiting Combinations in General.

Several attempts were made to bring fire insurance exchanges within the scope of a common type of statute which prohibits combinations, contracts, agreements, etc., in restraint of "trade," "commerce," "business," "dealings in commodities," "products," etc. The following law of Iowa[17] furnishes an illustration of this general type of law, which exists in many other States[18] and is hereafter referred to as "anti-trust" legislation.

Pools and Trusts.

"Any corporation organized under the laws of this or any other State or country for transacting or conducting any kind of business in this State, or any partnership, association or individual, creating, entering into or becoming a member of or a party to any pool, trust, agreement, contract, combination, confederation or understanding with any other corporation, partnership, association or individual, to regulate or fix the price of any article of merchandise or commodity or to fix or limit the amount or quantity of any article, commodity or merchandise to be manufactured, mined, produced or sold in this State, shall be guilty of a conspiracy."

Cases involving such statutes have principally raised the question of whether their general terms included insurance, and decisions have usually been to the effect that they do not. Thus in several cases it has been declared that insurance is not "trade" nor a "commodity" within the meaning of these words as used in the acts.[19] "We conclude that the word must be construed in a more restricted sense, and as synonymous with 'traffic' * * * but

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[15] Continental Ins. Co. vs. Board of Fire Underwriters of Pacific, 67 Fed. 310 (1895).

[16] State vs. Board of Underwriters of Allegheny County, Court of Common Pleas, Pittsburgh, Pa., May 7, 1913.

[16x] McCarter vs. Firemen's Fund Ins. Co., et al., 73 Atl. 85.

[17] Code of Iowa, 1897, Sect. 5060.

it does not embrace the business of insurance, which is trade only in the sense that it is an occupation or employment. * * * It is only by a strained construction that the word commerce can be made to embrace the business of insurance. * * * Insurance is neither produced, consumed, manufactured, transported, nor sold in the ordinary signification of any of these words, and therefore it is not within 'the plain import' of the language employed in the act."[20] The above objections were successfully overcome in Texas by the insertion in the statute of the word "business."[21] It is evident that general statutes of the nature we have been discussing, in order to include insurance within their scope, must be specific and accurate in wording.[22]

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[18] The following is a list of State anti-trust statutes, not specifically mentioning insurance, with their citations, existing January 1, 1914:
Alabama, Code 1907, Chap. 69, Sect. 7579 et seq.
Arizona, Laws 1912, Chap. 73.
California, Laws 1909, Chap. 362.
Colorado, Laws 1913, Chap. 161.
District of Columbia, U. S. Statutes at Large 209, Sup. 2d d., 762.
Hawaii, Revised Laws, Sect. 3100.
Idaho, Laws 1909, p. 297.
Idaho, Laws 1911, Chap. 215, p. 688.
Illinois, Laws 1891, p. 78, amended to 1901.
Indiana, Burns Annotated Statutes, 1908, Sect. 3878, et seq., Sect. 3884 et seq., and Sect. 3889 et seq.
Iowa, Code 1897, Sect. 5060, and Laws 1909, Chap. 255.
Kentucky, Russell's Statutes, 1909, Sect. 3717 et seq.
Louisiana, Laws 1890, Act 86, and Laws 1892, Act 90.
Maine, Revised Statutes 1903, Chap. 47, Sect. 53 et seq., Laws 1913, Chap. 106.
Massachusetts, Laws 1908, Chap. 454, Sect. 1 et seq., Laws 1911, Chap. 503, and Laws 1912, Chap. 651.
Michigan, Laws 1899, No. 255, and Laws 1905, Act 329.
Minnesota, General Statutes 1913, Sect. 8973 et seq.
Montana, Laws 1909, Chap. 97, Sect. 1 et seq.
New Jersey, Laws 1913, Chap. 13.
New Mexico, C. L. 1897, Sect. 1292.
New York, Consolidated Laws, Chap. 20, Sect. 340 et seq.
North Carolina, Laws 1913, Chap. 41.
North Dakota, Laws 1907, Chap. 259.
Ohio, General Code 1910, Sect. 6391 et seq.
Oklahoma, Revised Laws, Sect. 8220, and Laws 1908, p. 750.
Porto Rico, Revised Statutes, Sect. 2373.
South Dakota, Laws 1909, Chap. 224.
Tennessee, Laws 1903, Chap. 140.
Utah, Hammond and Smith's Compiled Laws 1907, Sect. 1753 et seq.
Wisconsin, Sanborn and Berryman's Wisconsin Statutes, Sect. 1791, and Laws 1905, p. 944.
Florida and one or two other States have laws applicable to certain industries, which have not been included in the above list, inasmuch as they are not applicable to insurance. See, for example, Florida General Statutes 1906, Sect. 3160, referring to meats and other edibles.

[19] Queen Ins. Co. vs. Texas, 86 Tex. 250, interpreting Act of March 30, 1889; Aetna Insurance Co. vs. Commonwealth, 106 Ky. 864 (1899); State vs. American Surety Co., 133 N. W. 235 (1911), interpreting Art. 2, Chap. 91a, Comp. Stat. Nebraska, 1911. Reversed in 135 N. W. 365 (1912).

Specific Anti-Compact Laws.

Owing to this necessity for definiteness it became the practice to specifically enumerate insurance as included within the scope of the various acts.[23] The following law of Arkansas[24] is an illustration of the type.

Anti-Trust Regulations.—Defining Conspiracy to Regulate Prices.

Sec. 142. Any corporation organized under the laws of this or any other State, or country, and transacting or conducting any kind of business in this State, or any partnership or individual, or other association or persons whatsoever, who are now, or shall hereafter create, enter into, become a member of, or a party to, any pool, trust, agreement, combination, confederation or understanding, whether the same is made in this State or elsewhere, with any other corporation, partnership, individual, or any other person or association of persons to regulate or fix either in this State or elsewhere the price of any article of manufacture, mechanism, merchandise, commodity, convenience, repair, any product of mining, or article or thing whatsoever, or the price or premium to be paid for insuring property against loss or damage by fire, lightning or tornado, or to maintain said price when so regulated or fixed, or who are now, or shall hereafter enter into, become a member of, or a party to any pool, agreement, contract, combination, association, or confederation, whether made in this State or elsewhere, to fix or limit in this State or elsewhere, the amount or quantity of any article of manufacture, mechanism, merchandise, commodity, convenience, repair, any product of mining, or any article or thing whatsoever, or the price or premium to be paid for insuring property against loss or damage by fire, lightning, storm, cyclone, tornado, or any other kind of policy issued by any corporation, partnership, individual or association of persons aforesaid, shall be deemed and adjudged guilty of a conspiracy to defraud and be subject to the penalties as provided by this Act. (Sec. 1, Act 1, 1905.)

Propriety and Scope of Anti-Compact Laws.

Inasmuch as the power to regulate insurance rests entirely with the States, combinations to prevent competition in rates have been held proper subjects

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[20] Queen Ins. Co. vs. Texas, 86 Tex. 264, 265.

[21] Amer. Fire Ins. Co. vs. State, 75 Miss. 24 (1897). Noyes, "Intercorporate Relations," Sect. 435, footnote.

[22] Queen Insurance Co. vs. Texas, 86 Tex. 250.

[23] The following laws enumerating insurance as covered by their provisions existed January 1, 1914:

Arkansas, Laws 1905, Act. 1, Sect. 1 et seq., as amended by Laws 1913, Act. 161.

Kansas, Laws 1889, Chap. 257, Sect. 1; General Statutes, Sect. 5185; Laws 1897, Chap. 265, Sect. 1; and General Statutes, Sect. 5142.

Mississippi, Code 1906, Sect. 5002, as amended by Laws 1908, Chap. 119, Sect. 1.

Missouri, Revised Statutes 1909, Chap. 98, as amended by Laws 1913.

Nebraska, Cobbey's Annotated Statutes 1911, Sect. 12,000 et seq. and Compiled Statutes 1911, Sect. 6281.

South Carolina, Civil Code 1912, Sect. 2437 et seq.

Texas, General Laws 1903, Chap. XCIV, p. 119, as amended by General Laws 1907, and Revised Civil Statutes 1911, Art. 1454.

Missouri now has a law, however, providing for supervision.

for the exercise of State powers. Where a State legislates against "trusts" this term may be made to include, by definition, such a combination as above mentioned. Thus in State vs. American Surety Company,[25] the court said in relation to a statute of Nebraska: "Evidently the words 'trade and business' are intended as a generic term to embrace all the transactions and practices set forth in the preceding section, and properly include the regulation of insurance contracts in restraint of competition." In German Alliance Insurance Company vs. Hale,[26] such laws were regarded as a valid exercise of the State's police power. The courts have held that an act providing for the expulsion from the State of any foreign company participating in a pool or combination was within the power of the State, which had no limitation by State or Federal constitution.[27]

The question of the extent of application of a State law to combinations and agreements made outside the State is a doubtful one.[28]

Constitutionality of Anti-Compact Laws.

Statutes designed to prohibit rate-making associations have been attacked as contrary to the State and Federal constitutional provisions regarding the right of contract, equal protection and due process of law.

The first of these was introduced as a basis of complaint in the case of Greenwich vs. Carroll,[29] and the decision at first favored the contention, stating that the law prevented fire insurance companies from making contracts which other persons might make, such as laborers fixing the price of their labor. The verdict of the Circuit Court was reversed, however,[30] and the law in question[31] held not to contravene the State or Federal constitutions.

A law which provides that any insurance company connected with a tariff association should be liable for 125 per cent of any loss or damage[32] has been considered not to deprive the company of the equal protection of the laws or deny it due process of law.[33] A provision that such a company could not enforce the stipulations of the standard fire policy requiring notice and proof of loss was held equally valid.[34]

Devices to Evade Anti-Compact Laws.

Wherever questioned the attempts to accomplish the same objects without violating the laws have been unsuccessful. Thus where agents had formed

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[24] Insurance Laws of Arkansas, 1913, Chap. XV, Sect. 142, p. 69.

[25] State vs. American Surety Co., 135 N. W. 365 (1912), reversing 133 N. W. 235 (1911).

[26] German Alliance Ins. Co. vs. Hale, 21 S. C. 246 (1911); see also Firemen's Fund Ins. Co. vs. Hellner, 49 So. 297 (1909).

[27] Hartford Fire Ins. Co. vs. Perkins, 125 Fed. 502 (1903).

[28] See Hartford Fire Ins. Co. vs. State, 89 S. W. 42 (1905), and State vs. Lancashire Fire Ins. Co., 66 Ark. 466 (1899).

[29] 125 Fed. 121 (1903). See also Niagara Fire Ins. Co. vs. Cornell, 110 Fed. 816.

[30] Carroll vs. Greenwich, 26 Sup. Ct. Rep. 66, 199 U. S. 401 (1906).

[31] Code of Iowa, 1897, Sect. 1754.

[32] Alabama Code, 1896, Sect. 2619, Code 1907, Sect. 4594.

[33] German Alliance Ins. Co. vs. Hale, 21 Sup. Ct. Rep. 246 (1911); Firemen's Fund Ins. Co. vs. Hellner, 49 So. 297 (1909).

[34] Aetna Ins. Co. vs. Kennedy, 50 So. 73 (1909); Continental Ins. Co. vs. Parkes, 39 So. 204 (1905).

an association, a requirement of which was that they were not to forward policies until the same had been submitted to the "stamping department"[35] of the association, the court held that the acts of the agents were the acts of the companies, ratified by the latter also by the receipt of the premiums.[36] Upon the passage of an anti-compact law in Missouri, the Association of Fire Underwriters of Missouri was dissolved and an independent rater supplied books of rates to the companies. Agents and brokers formed a club known as the "Underwriters' Social Club" for the purpose of maintaining a stamping department. This was characterized by the court as "a plain, palpable, but bungling pool, trust, agreement, combination, confederation and understanding, organized to avoid said anti-trust statute," and illegal.[37]

In the light of the foregoing decisions it is hard to see how insurance companies can escape the effects of statutes specially prepared to apply to them, regardless of the inadvisability of attempting to do so, since a rewording very simply accomplishes the object of the legislator. Only two decisions[38] have been found which upheld the legality of such combinations or associations, under specific prohibitory laws, and one was reversed by a higher court, although the advantageous features of rate-making associations have sometimes been admitted.[39] The tendency has rather been to allow the statutes a wide scope than to limit their application, and recent decisions have shown no change in this attitude. In 1912 combinations of this nature, defined by law as "trusts," were again stated to be unlawful.[40]

State Rating Laws.

The importance of the two types of laws described was considerably lessened, however, by the recognition of some States of the principle of co-operation. These States, which unconsciously took the first step toward a rational treatment of the issue, admitted what they had long denied, that all companies should charge the same rate, but determined that the States should fix the rates charged.

While recent rate legislation may be described as consisting of laws which require the States' supervision of rates and those authorizing Government fixing of rates, it may be further classified as

(1) Laws requiring the filing of rates with State officials.

(2) Laws providing for a revision by the companies of rates found by a hearing to be unfair.

(3) Acts creating State Boards to fix and enforce rates.

(I) The first type, requiring the filing of rates, is illustrated by the law of Arkansas.[41] Corporations and associations doing business in the State are required to file a schedule of rates with the State Auditor or Insurance Com-

[35] See pp. 14, 26.

[36] State vs. Aetna Ins. Co., 150 Mo. 113 (1899).

[37] State vs. Firemen's Fund Insurance Co., 152 Mo. 1 (1899).

[38] Greenwich vs. Carroll, 125 Fed. 121 (1903); Niagara Fire Ins. vs. Cornell, 110 Fed. 816.

[39] State vs. Aetna Ins. Co., 150 Mo. 113 (1899).

[40] State vs. American Surety Co., 135 N. W. 365 (1912).

[41] Laws 1913, Act. 159, approved March 12, 1913.

missioner, and underwriters may employ a common expert to inspect and rate risks and advise the premiums to be charged. Such premiums must be uniform for all risks rated under the same schedule. Such laws exist in several States and are simply important as exemplifying the permission to co-operatively determine rates.

(II) An example of the second type is found in the law of Kansas, 1909.[42] Basis schedules are required to be filed with the Superintendent of Insurance, showing proposed rates and any matters affecting such rates. Ten days' notice must be given of changes in rates and the new rates filed, unless otherwise permitted by the Superintendent of Insurance, who has the power to order changed excessive, unreasonable or inadequate rates. Contracts may be made affecting risks for which no schedule has been filed, provided a schedule is filed within 30 days after the risk is written. Schedules and local tariffs filed as above are open to the inspection of the public and local agents are required to exhibit copies of the same. Appeals from the Superintendent's decisions may be taken to the district courts of the State.

The law of Massachusetts provides a Board of Appeals, consisting of two citizens of the Commonwealth and the Insurance Commissioner, to consider complaints of unfair or discriminatory rates and make such recommendations as it deems advisable.[43]

The oldest of the three acts above mentioned, and the only one on which a decision has been rendered, as far as known, is that of Kansas. This was attacked in the courts [44] on the ground that it was unconstitutional, constituting an interference with the right of private contract, guaranteed by the Fourteenth Amendment. This view was not upheld by the court, which considered the act a valid exercise of the State's Police Power. On April 20, 1914, the United States Supreme Court decided the act was constitutional.[45] It was said that "business, by circumstances and its nature, may rise from private to be of public concern, and be subject, in consequence, to governmental regulation. * * * Contracts of insurance, therefore, have greater public consequence than contracts between individuals to do or not to do a particular thing whose effect stops with the individuals. * * * It is, therefore, within the principle we have announced."[46]

The dissenting opinion objected on the ground that the majority decision opened the way to State price-fixing on any sort of an article. This is one of the most important of recent rate decisions.

The State rating acts providing for the actual promulgation of rates by the States remain to be discussed.

The public interest in common law actions and anti-trust statutes against underwriters' associations and in the revision of rates by the State

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[42] Laws 1909, Chap. 152. A similar law recently existed in Missouri (Act of March 18, 1911), entitled the Oliver State Rate Act, but was practically repealed by the Orr Act, March 24, 1913 (Laws 1909, Chap. 98, as amended by Laws 1913).

[43] Acts 1911, Chap. 493.

[44] German Alliance Ins. Co. vs. Barnes, 189 Fed. 769 (1911).

[45] German Alliance Ins. Co. vs. Lewis, 34 Sup. Ct. 612.

[46] German Alliance Ins. Co. vs. Lewis, pp. 618, 619, 620.

was considerably diminished by the passage of more radical legislation.

(III) These statutes, commonly known as State rating acts, are the ones most strenuously objected to by the companies, although it must be recognized that the laws providing for revision of rates by State officials practically give the latter the authority to determine what the rates shall be. This result is not obtained with the same ease as under the rating acts, however, as many revisions may be necessary to attain the desired ends. The law of Kentucky,[1] prominent because of the withdrawal from the State of the companies upon its passage, may be selected as an example of this legislation, although similar laws exist in Texas, Louisiana and Nebraska[2] and were proposed in Mississippi and Florida.[3]

The supervision of rates is delegated to the Insurance Commissioner and two citizens appointed by the auditor, and for this purpose the companies are required to file general basis schedules, specific rates, rate cards, inspection reports of towns and a basis schedule of the Analytic System. These may be prepared by an agent employed by the companies in common. The rating board is expected to consider the reasonableness of rates and the selection of basis tables. The significant feature of the act, however, is that the Board may also prepare reasonable schedules and after the promulgation of these it is unlawful for any company to use a rate obtained by any other. The information necessary for the preparation of such rates the companies are required to furnish. The records of the Board are open to public inspection and the companies' agents are required to display the promulgated rates. The Board has access to the records of underwriters' associations. An appeal from its decision may be had to the Circuit Court of the State.

The companies proposed a substitute for the above law which endowed the Insurance Commissioner with these powers instead of a rating board, on the ground that there would be less danger of political influence; but this failed of adoption. The Western Union considered the withdrawal of its members from the State because of dissatisfaction with the act, but the underwriters could not agree on this action and decided to bring a bill in equity in the Federal District Court to restrain the enforcement of the act. This Court decided against the companies,[4] saying "The business of fire insurance is not impressed with a public use in the sense that the public can demand service, but it has at least a quasi-public, as distinguished from a purely private, character." Accordingly it was held that the act was within the power of the State.

This was a great disappointment to the companies, as it was estimated that the new law would cost them about $90,000.[5] Furthermore, the State Board ordered that new rates involving a reduction on dwellings, for example, of 30 per cent should go into effect March 15, 1913; but in March the reduc-

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[1] Laws of Kentucky, 1912, Chap. 5.

[2] Texas, 1910; Louisiana, 1910, Act 219; Nebraska, Insurance Code, 1913, Art. II; applies only to surety companies.

[3] Mississippi, February, 1912. See United States Review, February 22, 1912. Florida, April, 1913, House Bill No. 3.

[4] Citizens Insurance Co. vs. Clay, 197 Fed. 435 (1912).

[5] United States Review, April 4, 1912.

tion was diminished to 10 per cent, it having been shown that the companies had made no profit even at the original rate.[6]

In the following year the law previously analyzed was modified slightly by the passage of the Glenn-Greene Amendment. This was extremely radical as passed by the House, giving the Board arbitrary powers subject to little or no restraint, as well as the right to fix maximum rates instead of the mandatory rates provided for in the original bill. Such rates would not have had even the mandatory rates' advantage of preventing price-cutting and discriminations, the real evils in insurance. This amendment was considerably modified before passing the Senate.

The Kentucky rate law has been tested in the United States District Court and the opinion rendered[7] was that insurance was at least of a quasi-public character and subject, therefore, to State regulation. The legislature may, therefore, require companies to file data and appoint a board to fix the only lawful rates, this constituting no impairment of the rights of a company organized in another State and licensed to do business in Kentucky. The classification of companies for rate-fixing purposes cannot be considered as denying to all the equal protection of the laws and, therefore, is not unconstitutional.

In Nebraska, however, a board was provided to establish the rates to be charged by all surety companies doing business within the State. In an action brought by the American Surety Company the court declared that this was unconstitutional, depriving such companies of property without due process of law, in violation of the Fourteenth Amendment.[8]

The constitutionality of such laws is, therefore, an open question at the present time, with a tendency apparent to hold them within the States' powers. Against such a tendency we find the decision in the surety case and certain defects in the operation of these statutes. Likewise a strong dissenting opinion which favored the companies was filed in the case of Citizens Insurance Company vs. Clay.

Results of State Regulation.[9]

The earliest attitude of States toward insurance combinations, as is natural, was one of indifference. While the common law was available for the redress of wrongs, either real or fancied, it was seldom made use of, although one or two cases of comparatively early date may be found. Some State constitutions contain prohibitions against monopoly and restraint of trade.[10] With the development of antagonism to all forms of combinations, the common

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[6] New York Journal of Commerce, March 8, 1913.

[7] Citizens Insurance Co. vs. Clay, et al., 197 Fed. 435 (1912).

[8] American Surety Co. of New York vs. Shellenberger, et al., 183 Fed. 636 (1910).

[9] For an extended discussion of the historical development of fire insurance legislation see the author's "Commonwealth vs. Co-operation," Rough Notes, April 22, 1915.

[10] Arkansas, Art. II, Sect. 19; Georgia, Art. IV, Sect. 2, Par. 4; Kentucky, Sect. 198; Louisiana, Art. CXC; Maryland, Art. XLI; Mississippi, Sect. 198; New Hampshire, Art. 82; North Carolina, Art. I, Sect. 31; North Dakota, Art. VII; Oklahoma, Art. IX, Sect. 45; South Dakota, Art. XVII, Par. 20; Tennessee, Art. I, Sect. 22; Texas, Art. I, Sect. 26; Washington, Art. XII, Sect. 22; Wyoming, Art. I, Sect. 30, and Art. X, Sect. 8.

law was deemed inadequate protection and anti-trust statutes became common. Their object, in brief, was to destroy combination and promote—even enforce competition. By them the States said, "There shall be no measurement," for measurement presupposes a standard, which is possible only by co-operation.

This attitude is now being very generally recognized as fallacious and inadequate, inasmuch as it offers no inducement for a solution of the problem of equitable rating. State authorities speak of these laws as follows: "If there are any instances of anti-compact laws having served to reduce the cost of fire insurance anywhere, I have failed to find them. * * * From general observation I am convinced that a rate-controlling compact or monopoly never existed in the fire insurance field. * * * I think we can safely set it down as a fact that the condition of free and open competition sought to be retained by the passage of anti-compact laws has promoted rather than prevented high fire insurance rates."[11] "Inequality and injustice must necessarily result from the operation of this system. * * * In my opinion competition in fire insurance rates is illogical, opposed to sound public policy and undesirable from every standpoint."[12] The statement of the Merritt Commission of New York State to investigate fire insurance may be summarized as follows:

(1) The making of equitable rates demands co-operation.
(2) Open competition weakens the protection given and eliminates the smaller companies.
(3) The only alternative to open competition is combination, not merely to make, but to maintain rates.
(4) The effect of anti-compact laws has been not to bring back a state of open competition, for this is an impossible condition, but to introduce a weakened substitute for combination, the selling of "advisory" rates by an independent rater.
(5) The discrimination in anti-compact States has become so offensive that there is a strong movement toward regulation.[13]

Lack of space alone prevents quotations from many other sources to the same effect.[14]

The results of all the State rating laws were very similar. Kentucky furnishes the most recent illustration. After the rejection of the companies' substitute bill giving the Insurance Commissioner power over rates, the latter threatened to withdraw from the State in a body. A committee of leading underwriters from Hartford, New York and Chicago conferred with the Gov-

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[11] Fire Marshal Peterson, of Minnesota. See A. F. Dean, "State Regulation in the Light of Experience," Chicago, 1909, p. 9.

[12] Thomas B. Love, Insurance Commissioner of Texas. See A. F. Dean, "State Regulation," Chicago, 1909, p. 9.

[13] Report of Joint Legislative Committee of New York to investigate Insurance. Submitted February 1, 1911, pp. 76, 77.

[14] W. N. Johnson, address at Nashville, Tenn., January 30, 1909; C. C. Nadal, "Insurance Rate-Making Associations." Fidelity and Casualty Co. of New York, 1912; Attorney General Straus' advice to Governor Crothers of Maryland, in re the petition to proceed against the Association of Fire Underwriters of Baltimore; William Emmet, Superintendent of Insurance, New York, Report for 1913.

ernor, and while meetings to consider the situation were being held a $150,000 fire occurred at Hogdensville, Ky., in which 23 buildings were destroyed while covered only by $50,000 insurance. Most of the owners were unable to build without reimbursement for their loss and were unable to obtain loans without insurance protection.

Louisville banks, anxious as to their security, requested information from borrowers as to the value of their merchandise, the amount of insurance carried, the amount maturing in each month until October and what arrangements, if any, had been made for replacing this insurance.

By March 10 forty-seven companies are reported to have withdrawn from the State[15] and two weeks later industrial concerns were considering the removal of their places of business to other States. There was estimated to be in bond in the State alcoholic liquor valued at $162,000,000, represented by storage receipts which, with insurance policies attached, were pledged as collateral for loans. The banks desired these loans liquidated, if further insurance could not be obtained, and whiskey, tobacco and other commodities were not acceptable as collateral for proposed loans without insurance. Commercial credit was restricted by manufacturers, wholesalers and banks.[16]

The pressure by business interests was so great that a conference was held in April, 1914, for the purpose of having the State and the companies make such concessions as would enable the latter to resume business. As the companies' demand was non-enforcement of the Glenn-Greene Amendment and the State would offer no concessions of this nature it was a flat failure.[17] In June an agreement was reached containing the following important features:

(1) The Business Men's Committee would enter suit to test the constitutionality of the law and the Insurance Board would not enforce the provisions of the Glenn-Greene Amendment until the question of constitutionality had been determined by the courts. (2) The Governor would appoint a committee, one member to be selected by the State Insurance Board, one member by the National Board of Fire Underwriters, and one member by the Committee of Business Men, to make an exhaustive study of State laws regulating rates with a view to formulating legislation on the subject. (3) The Actuarial Bureau would furnish memoranda of remediable defects to the State Insurance Board on risks rated hereafter, the Board agreeing to refrain from calling on the companies or the Bureau for copies of surveys or classification figures except to test the accuracy of the application of a schedule. (4) All companies which had withdrawn from the State would be permitted to resume business without the application of any penalty. (5) Rates would be reduced by the Actuarial Bureau wherever improvements were made. (6) The Business Men's Committee would guarantee the faithful execution of the agreement. Pursuant to this understanding, the companies resumed business in Kentucky, and the Circuit Court, on June 12, held the Act unconstitutional and issued a temporary order restraining its enforcement.

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[15] U. S. Review, March 12, 1914. Twenty had withdrawn on March 9.
[16] U. S. Review, March 26, 1914.
[17] U. S. Review, April 23 and 30, 1914.

In Missouri similar events transpired. After a long dispute the State finally realized the impossibility of imposing such onerous burdens on the companies and agreed that the Orr Law, passed in 1913, should not be enforced pending an investigation by a commission. The Commission's report in 1915 formed the basis of a proposed law of the type next to be described.[18]

The foregoing description of State rating laws makes it apparent that these, although possessed of proper purposes, namely publicity, protection of the public and prevention of discrimination, are stronger medicine than the disease requires. They are but one step in the development of a logical, reasonable treatment of the rate question. The power to revise is, in the last analysis, the power to establish; we may consider in the same place, therefore, the objections to the laws which provide for the revision or fixing of rates by State boards. The following are alleged to be the difficulties and evil results of State rating:

(1) It is contended that they interfere with freedom of contract with respect to a business which has, as we have seen, been held by some courts to be of a private and not of a public nature. This view was very clearly stated in the companies' brief in connection with the Kentucky law.[19]

"Has the State the power or the legal right to fix the price at which a purely private corporation shall sell its commodities?

"The test of whether a use is public or not is whether a public trust is imposed upon the property, whether the public has a legal right to the use which cannot be gainsaid or withdrawn at the pleasure of the owner.

"The business of fire insurance is not a public business, and it is not impressed with a public use, but, on the contrary, it is a private business, transacted by purely private companies.

"State regulation of the rates and charges of purely private corporations, or private individuals, who transact a private and not a public business, is clearly prohibited by the Fourteenth Amendment to the Constitution."

(2) It is unfair for the State to limit the amount which the companies may collect in premiums, without guaranteeing them against loss. If the State has the privilege of deciding what rates are not exorbitant, it should also assume the burden of recompense if it has fixed rates which are inadequate.[20] As stated by Mr. George W. Babb: "It appears to me to be self-evident that whoever pays the losses should make the rates, and whoever makes the rates should pay the losses. If the State makes the rates the State should pay the losses and take the premiums. If the State makes maximum rates for the insurance companies, leaving the latter to pay the loss, the State should guarantee a reasonable profit on the business."[20] It may say that any dissatisfied underwriter may withdraw, but the results of this attitude have been described.

(3) The companies have urged that it is unfair to require them to con-

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[18] Report of Commission to Investigate Insurance, Missouri, 1915.

[19] The analysis given appeared in the United States Review.

[20] President's address, Proceedings of 46th Annual Meeting of the National Board of Fire Underwriters, May, 1912, p. 28.

tribute through taxation thousands of dollars to support a State rating board, which will be of no additional benefit to them and the cost of which may exceed that of the method which they privately maintained. Thus in Kentucky a fund of $25,000 was required to be pro-rated among the companies, and this was considered by them as confiscation of property without due process of law.[21]

(4) Political influence may exert a power for the benefit of special classes which should be used in obtaining justice for all. The New York Legislative Committee in its report said:[22] "This is a very dangerous power; it is conceivable that it might be used for political purposes; at any rate he who exercised the power would have effective pressure brought to bear on him from only one direction, that is, to reduce the rates, while, at least in certain emergencies, the situation might demand an increase."

(5) The supervision of the business, although requiring ability and experience, will generally devolve on those whose only qualification is their participation in political activities. To make the rates the State must collect statistics, presumably from the companies; employ experts, presumably experienced insurance men; and use schedules, either those now used by the companies or their own expensive substitutes. "The situation must be very aggravated that would warrant the State in assuming such an extended and technical piece of work."[23] "Our investigation leads us to the conclusion that any attempt by the State to assume the function of creating or originating rates for fire insurance would be a serious mistake."[24]

(6) The inequalities and lack of relation present in State and municipal taxes afford a presumption that the fire tax will be inequitably distributed.

(7) The compilation of statistics is possible only with the co-operation of underwriters.

(8) If the State assumed entire control of the business it could not accomplish its objects, judging from the results in other countries where State insurance has been tried. Their experience, it is claimed, shows that insurance conducted by the State neither reduces rates nor yields a profit.[25] What can be accomplished then merely by the control of rates?

(9) Average and distribution are bases of fire insurance and rates should not be founded on the experience of the separate States. The theory of the Texas Board at the outset was that Texas premiums should pay for Texas losses.[26] The issue correctly stated would be, shall Texas policyholders evade liability for losses in other States and outside policyholders help to pay Texas losses? The New York Committee report states: "Insurance is based on gen-

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[21] United States Review, April 4, 1912.

[22] Report of the Joint Committee of the Senate and Assembly of New York on Insurance Investigation, February 1, 1911.

[23] Ibid., p. 52.

[24] Report of Illinois Fire Insurance Commission, 1911, p. 74.

[25] A. E. Wall, "Some Popular Fallacies with Regard to Fire Insurance," "The Market World and Chronicle" (now "The Economic World"), November 8, 1913, p. 607.

[26] United States Review, March 14, 1912.

eral average; no one locality is sufficient for this, not even a State, not even the United States in the case of large conflagrations. If rate-making were lodged with the State and the experience of that State had been favorable, the tendency would be to make rates purely upon this experience. The most serious effect of this would be that, in case of a large conflagration, it would be impossible for a company to recoup itself, for each State in standing upon its own experience would refuse to contribute to any outside loss; the result would be that the State in which the conflagration occurred would have to pay the entire loss. This would, of course, break down the very first principle of insurance, for one State is insufficient to stand the shock of a large conflagration."[27] Notwithstanding, the danger of a single city's experience being taken as a basis appears. In April, 1912, the City of Austin, Texas, applied to the Texas Insurance Rating Board for a compulsory reduction of its rates to a lower plane than those of any other city in the State. The argument advanced was that the rates for Austin should be based upon the city's own experience and that citizens of Austin should not be compelled to pay premiums sufficient to take care of fire losses in other communities. On the other hand, in some States the fallacy of such an arrangement is realized. Mr. F. W. Potter said:[28] "I am more than ever persuaded that it is the duty of those States having rational insurance laws, and making a fair contribution to the common fund, to prohibit by law the admission of companies which operate in States where, under the statute, fire insurance is not permitted to exercise its functions with reasonable freedom, nor to collect a premium commensurate with the hazards in such States."

This awakening of some States necessarily has its disadvantages from the companies' viewpoint. They seem to be between the upper and lower millstones—compelled to do business in some States at inadequate premiums and prevented from collecting any at all in others because of it. It would seem, therefore, that State rating laws serve only to reduce premiums and that to such an extent as to jeopardize the safety of the companies and to cause them to withdraw from a business without profit. While the State rating boards have the power to correct the evils which have been stated to exist, it would be advisable to attain this end by a less dangerous method.

In brief, State rating laws appear to be, in the first place, a stronger remedy than the disease requires and, secondly, one which, even as it cures, creates new ills. It would be advisable to retain the economic advantages of associations and to eliminate their objectionable features by less stringent measures. This is provided for by laws similar to that of New York, West Virginia and North Carolina.[29] Such acts stop short of actually fixing insur-

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[27] Report of New York Legislative Investigating Committee, 1911, p. 52. See also E. G. Richards, "Experience Grading and Rating Schedule."

[28] Annual Report, Commissioner of Insurance, 1912. Also see New York Journal of Commerce, August 25, 1913, and "The Market World and Chronicle" (now "The Economic World"), July 5, 1913.

[29] New York Laws 1909, Chap. 33, Sect. 41, as amended by Laws 1911, Chap. 460 and Laws 1912, Chap. 175. North Carolina, Laws 1913, Chap. 145. West Virginia, Acts 1913. Other States have since adopted this form of law.

ance rates, and avoid all of the objections and disadvantages inherent therein. They allow the associations which have been so beneficial in the past to exist and yet subject them to the closest supervision by the Insurance Department.

Laws Providing for Supervision.

The New York, West Virginia and North Carolina laws are identical and provide that corporations, associations and bureaus for suggesting, approving or making rates to be used by more than one underwriter shall:

(1) File with the Insurance Commissioner a copy of their articles of agreement, by-laws and a statement of business addresses and names of members.
(2) Furnish such other information as the Commissioner may require.
(3) Submit to visitation, supervision and examination by the Commissioner as often as he deems expedient and at least once every three years.
(4) File rates and schedules at request of the Commissioner.
(5) Keep records of proceedings and upon request furnish the insured with information as to his rate and a copy of the schedule by which his property was rated.
(6) Provide means of hearing interested parties before their governing or rating committees or other proper authorities.

The associations and bureaus are prohibited from:

(1) Specifying that the rates depend upon placing the whole or a specified amount of insurance at such rates.
(2) Requiring that all insurance be taken with subscribers to such organizations.
(3) Discriminating in rates. The Commissioner may hear cases and order discriminations removed and they shall not be removed by an increase in rates unless justifiable.

Whereas other laws prohibited co-operation, even attempted to enforce competition and took away the right of the companies to say at what price they would sell insurance, these acts permit and recognize associations with all their benefits, on the one hand, and prohibit abuses, on the other. In New York all complaints seem to have been promptly investigated and evils are being corrected. An extensive investigation of the most important association in New York was conducted, which analyzed its deficiencies at length.

The report of the Merritt Committee of New York, acknowledged to be the fairest and most intelligent summary of the business yet given, said:

"It is, therefore, recommended that no anti-compact bill be passed, but that in place thereof a statute be enacted that **will permit combination under State regulation**, such regulation to stop short of actually fixing the price at which the companies shall sell their insurance, but which will be of such a positive nature that all forms of discrimination in rates will cease." * * * [30]

The recent report of the Missouri Investigating Committee states: "A rating or actuarial bureau should be open for membership to all authorized com-

[30] Report of the Joint Committee of the Senate and Assembly of New York, February 1, 1911, p. 125.

panies * * * subject to visitation, inspection and examination of the Superintendent of Insurance."[31] The report of the North Carolina Investigating Committee recognized in part the advantages of the association.[32] A vice-president and counsel of one of the large companies wrote:[33] "There would seem to be, however, a middle course between the two extremes of State rate-making, on the one hand, with all the consequent defects * * * ; and, on the other hand, complete company control of rate-making without the steadying influence for its control of laws and State supervision to hold the rate-making body up to a full sense of responsibility for its action to the representatives of the people. The necessary joint control and balancing of influence can, I think, be secured by leaving the companies' selection of the person or persons who shall make rates, but giving to the Superintendent of Insurance the power of examining into the office and methods of the rate-making body, * * * the power to compel removal of discrimination in rates, * * * jurisdiction to review complaints that the schedule used by the rate-making body has not accurately applied to a particular risk."

Since this study was begun the principle of association with adequate regulation has received greater recognition. Prior to 1915 six States, New York, New Jersey, West Virginia, North Carolina, Washington and Kentucky, had adopted legislation of this nature and during the past year Pennsylvania, Michigan, Missouri, Minnesota, Iowa and Oklahoma enacted such laws. Kentucky and Missouri, which have tried radical prohibitory legislation, will be noted in this list.

In foreign countries little objection has been made to insurance associations making rates. In England one tariff association of practically all companies has existed since 1858, which determines rates for all important classes of property and it has never been found necessary to organize mutuals in order to reduce rates. The same situation exists on the Continent.[34] In Germany the private fire insurance companies formed a "Kartell," or association, in 1899, which has almost completely done away with competitive rate-making.[35]

After a discussion of various aspects of fire insurance rates and underwriters' associations a general summary of the conclusions reached would seem to be advisable.

(1) Fire insurance rates are receiving great consideration at the present time and are the greatest problem of the insurance business.

(2) Underwriters' associations, far from being useless or vicious, have certain definite economic functions.

(3) Certain evils are complained of, some of which are due to competition and others to lack of regulation.

(4) The evils complained of will not be removed by prohibiting combinations or by the State assuming price-fixing powers.

(5) Rational regulation, arising from careful investigation, and knowledge of the principles involved, of those associations which have hitherto performed their functions with reasonable success, will yield the greatest benefit to underwriters and the public.[36]

[31] Report of Findings and Recommendations of the Missouri Fire Insurance Commission, 1915.

[32] 1915, p. 7.

[33] David Rumsey, "A Suggestion of a Method for the Control of Fire Insurance Rates," "The Market World and Chronicle" (now "The Economic World"), December 6, 1913, p. 740.

[34] L. W. Zartman, "Discrimination and Co-operation in Fire Insurance Rating," Yale Readings in Insurance, Yale University Press, New Haven, p. 223.

[35] Fritz Brauer, "Wirkungen des Feuerversicherung Kartells."

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